

**UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK**

In re	Chapter 11
CELSIUS NETWORK LLC, <i>et al.</i>	Case No. 22-10964 (MG)
Debtors.	(Jointly Administered)

**INTERIM REPORT OF SHOBA PILLAY, EXAMINER**

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## I. Introduction

On September 29, 2022, the Bankruptcy Court appointed Examiner Shoba Pillay to investigate and report on topics related to Debtors Celsius Network LLC and related entities (“Celsius”).<sup>1</sup> In two subsequent Orders, the scope of the Examiner’s investigation has been clarified and expanded to include additional topics.<sup>2</sup> Two of the topics the Bankruptcy Court directed the Examiner to review are:

- An examination of Debtors cryptocurrency holdings, including a determination as to where the Debtors’ cryptocurrency holdings were stored pre-petition and are stored post-petition, and whether different types of accounts are commingled; and
- An examination as to why there was a change in account offerings beginning in April 2022 from the Earn Program to the Custody Service for some customers while others were placed in a “Withhold Account.”<sup>3</sup>

Following the Examiner’s appointment, the Bankruptcy Court entered a scheduling order to address claims made by two *ad hoc* groups. These groups

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<sup>1</sup> See *Order Approving Appointment of Examiner* dated September 29, 2022 [Dkt. 923]; *Order Directing Appointment of an Examiner Pursuant to Section 1104(c) of the Bankruptcy Code* dated September 14, 2022 [Dkt. 820] (“Examiner Order”). Unless otherwise indicated, all references to the “Dkt.” are to filings found on the docket for the lead case, *In re Celsius Network LLC*, Case No. 22-10964 (MG).

Debtors in this case are Celsius Network LLC; Celsius KeyFi LLC; Celsius Lending LLC; Celsius Mining LLC; Celsius Network Inc.; Celsius Network Limited; Celsius Networks Lending LLC; and Celsius US Holding LLC. For ease of reference, the Interim Report uses “Celsius” to include Celsius Network LLC and its affiliated debtors and debtors-in-possession.

<sup>2</sup> See *Order Approving Examiner’s Motion to Confirm Examination Scope or Alternatively For Expansion of the Scope of the Examination* dated November 1, 2022 [Dkt. 1260]; *Stipulation and Agreed Order Modifying the Scope of the Examiner’s Order* dated November 14, 2022 [Dkt. 1343].

<sup>3</sup> See Examiner Order at ¶ 3.

claim that the crypto assets held in what Celsius called Custody and Withhold accounts are property of the account holders, rather than property of Celsius's bankruptcy estates.<sup>4</sup> Because of factual overlap between this claim and the Examiner's investigation, the Court directed the Examiner to file an Interim Report addressing the following factual issues:<sup>5</sup>

- how and when the Custody and Withhold wallets were created;
- whether the Custody and Withhold wallets have only ever held Custody and Withhold Coins, respectively, and whether the Custody and Withhold wallets include coins that have been designated as pledged collateral;
- the process by which coins were transferred in and out of Custody and Withhold wallets;
- the balance of assets in Custody and Withhold accounts and Custody and Withhold liabilities in the ten (10) days before and after the pause by coin;
- the number and types of coins that are currently in Custody and Withhold wallets as a step in an unsuccessful attempt to withdraw coins off of the platform (to the extent ascertainable).<sup>6</sup>

This Interim Report addresses these questions and certain related issues within the scope of the Examiner's investigation. Because her investigation is ongoing, the Examiner reserves the right to supplement the Interim Report.

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<sup>4</sup> See Joint Stipulation and Agreed Scheduling Order By and Among the Debtors, The Committee, The Ad Hoc Groups With Respect to Custody and Withhold Issues dated October 11, 2022, Adv. Pro. 22-01142 [Dkt. 12].

<sup>5</sup> *Id.* at ¶ 7.

<sup>6</sup> *Id.*

## II. Executive Summary

In March 2018, Celsius launched its crypto asset-based finance platform. From its inception, Celsius’s “core” financial product and the focus of its marketing was the “Earn” program. Under the Earn program, Celsius’s customers transferred their crypto assets to Celsius in exchange for “rewards” that Celsius advertised as more attractive than other crypto investment opportunities. Customers could also borrow against crypto assets they deposited<sup>7</sup> with Celsius, using those assets as collateral. Celsius, in turn, used deposited crypto assets to generate income for Celsius and its operations and growth.

The contract governing the relationship between Celsius and its customers was called its Terms of Use. Celsius revised its Terms of Use eight times from its original Terms of Use dated February 1, 2018, until its last pre-petition Terms of Use dated April 14, 2022. Each of the Terms of Use after September 29, 2020 stated that by depositing crypto to Celsius’s Earn program, a customer transferred “all right and title” to their crypto assets to Celsius and that Celsius had the right to pledge, lend, or otherwise transfer or use a customer’s crypto assets. When customers transferred crypto assets to Celsius for deposit in an

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<sup>7</sup> This Report uses the term “deposits” to refer to customer transfers of crypto assets from wallets outside of Celsius’s control to wallets within Celsius’s control, without intending to signal a legal conclusion about crypto assets sent by customers to Celsius. Celsius has used both “deposits” and “transfers” in reference to these transactions. Separately, from a ledger perspective, this report (including the schedules provided in Appendix A) generally uses “deposits” to refer to all inflows into Custody or Withhold accounts, including not only new deposits of crypto assets, but also internal account transfers from a customer’s Earn account to a Custody (or Withhold) account at Celsius.

Earn account, the assets were swept from “bridge wallets” identified to a particular customer into a “main” or “aggregator” wallet that held crypto assets received from many sources. Once swept, the assets could no longer be traced back to a particular customer.

Intense regulatory pressure forced Celsius to change its business model. Specifically, in mid-2021, numerous state and federal regulators began investigating whether “Earn” accounts were securities offerings subject to registration requirements. On September 17, 2021, the New Jersey Bureau of Securities ordered Celsius to cease and desist from offering the Earn product to unaccredited investors and from accepting any additional assets into an existing Earn account.

In response, Celsius developed a “Custody” program for its unaccredited U.S. customers, which it launched on April 15, 2022, to meet New Jersey’s deadline for compliance. The Custody program allowed existing customers to continue to receive rewards for their existing Earn accounts but required them to make all future deposits into a Custody account. Crypto assets in a Custody account were not eligible for rewards, and under a new Terms of Use, title remained with the customer; Celsius stated that it would “not transfer, sell, loan or otherwise rehypothecate” those Custody assets.

Due to time pressure and lack of engineering resources, Celsius chose to rely on manual reconciliations and transfers of crypto assets without robust controls for the Custody program, with aspirations of developing a more effective process later. This same time pressure left Celsius without a viable solution for

unaccredited investor customers residing in nine states in which Celsius did not have the proper licenses to offer a Custody program.<sup>8</sup> Celsius blocked customers in these states from making further deposits to the Earn program, and instead designated post-April 15, 2022 transfers as being made to newly-designated “Withhold accounts.” There was no Terms of Use for Withhold accounts, and although ineligible for rewards, Celsius treated new deposits to these accounts as deployable for its revenue generation. Celsius also did not create separate wallets corresponding to the Withhold accounts and did not segregate or in any other way attempt to treat any crypto assets as the property of Withhold customers.

Celsius kept the Custody program largely confidential until it was announced on April 11, 2022. On the morning of April 15, 2022, when a Celsius U.S. customer logged into their Celsius app, the customer was informed that their default account would now be a Custody account, that all future deposits must be made to a Custody account, and that their existing Earn account would continue to earn rewards. The Celsius app also asked Custody customers to agree to new Terms of Use, which—for those who opted to click through to the actual terms—for the first time stated that ownership of crypto assets in a Custody account remained with the customer and that Celsius would not transfer, sell, loan, or otherwise rehypothecate those crypto assets. In response to inquiries or deposit by unaccredited customers residing in the nine states

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<sup>8</sup> The nine states were: Connecticut, Louisiana, Nebraska, Nevada, New York, North Carolina, Ohio, Vermont, and Washington.

where Celsius could not offer Custody accounts, Celsius informed them that their accounts were now in a Withhold status, that any new coins sent to their accounts would not be credited, and that they should withdraw any such newly-transferred crypto assets from Celsius.

To fund Custody accounts, Celsius moved crypto assets out of its commingled Main wallets into separate wallets designated for the Custody accounts. Because the crypto assets in the Custody wallets all arrived in aggregate transfers from Celsius's commingled Main wallets, Celsius did not treat any particular asset in the Custody wallets as belonging to any particular customer. And due to the decision not to develop a separate Custody infrastructure, when customers transferred new crypto assets into a Custody account, the crypto assets were deposited in the same manner as they had been under the Earn program.

Celsius's Custody program did not automatically balance the number of coins reflected in Custody accounts to the number of coins held in the Custody wallets. Celsius had to manually reconcile those balances. Celsius performed this reconciliation 53 times during the 83-day period between April 20, 2022 (when it first reconciled the Custody wallet holdings to the Custody accounts) and July 12, 2022 (the day before Celsius filed for bankruptcy).<sup>9</sup> Celsius did not have any memorialized rules or policies to guide this reconciliation process.

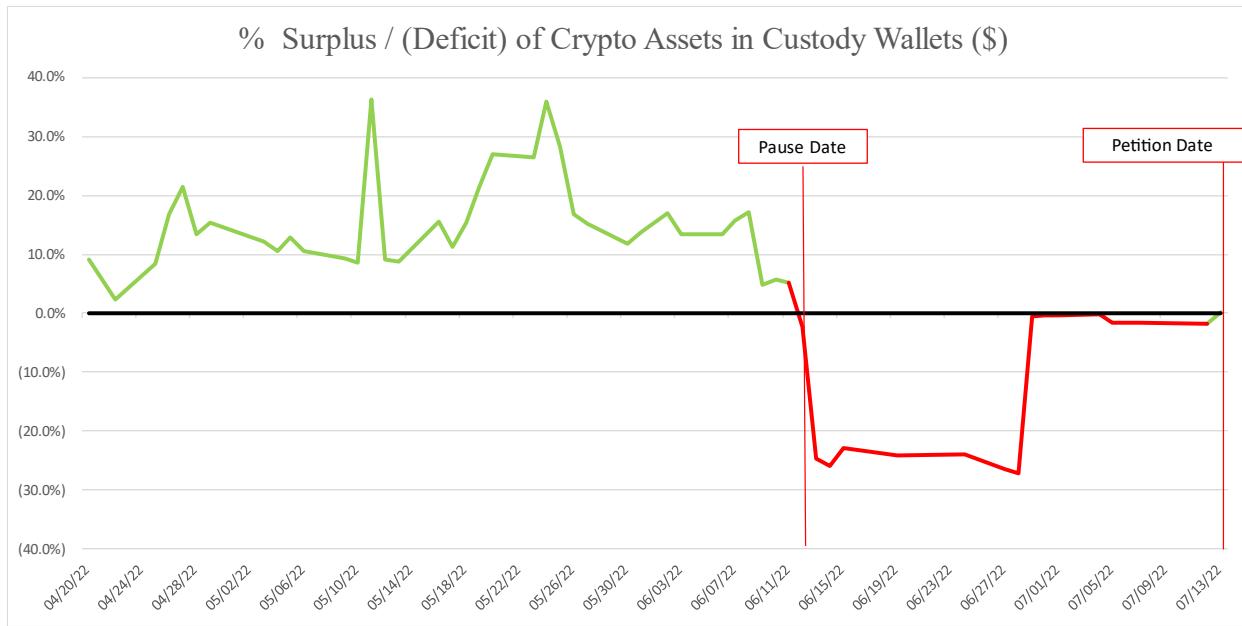
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<sup>9</sup> Celsius did not fund any shortfalls between the customer liability for Custody accounts and the assets in the Custody wallets from June 11 – June 27, 2022.

Celsius had a shortfall in its Custody wallets on 16 dates between April 20, 2022 and July 13, 2022. To cover these shortfalls, Celsius moved crypto assets from its Main wallets. And when there was an excess in the Custody wallets, Celsius moved the coins back to its Main wallets.

Beginning in May 2022, Celsius faced liquidity challenges. In its May 2022 Board Minutes, Celsius reported that its “capital sits near zero.” At the same time, between May 9, 2022 and May 24, 2022, customer withdrawals caused Celsius to experience a net loss of over \$1.4 billion in assets. By June 12, 2022, Celsius’s liquidity had dropped to the point where it could no longer honor customer withdrawal requests and Celsius announced that “due to extreme market conditions” it was “pausing all withdrawals.”

Attached as Schedule 2 is a report detailing the surplus or deficit in the Custody wallets beginning on April 20, 2022. As set forth in that Schedule, Celsius’s Custody wallets were overfunded through June 10, 2022, but the Custody wallets became underfunded on June 11, 2022. By June 24, 2022, the Custody wallets were underfunded by \$50.5 million, representing a 24% shortfall. Below is a summary of that information.



Following the Pause, customer account balances in the Withhold and Custody programs continued to increase even though the Pause halted customer withdrawal activity. This occurred because Celsius had limited ability to prevent customers from transferring new crypto assets to its platform, and also because after the Custody program was launched all customers (Earn and Custody) had to use Custody to withdraw their coins. And following the Pause, Celsius's systems allowed some customers to continue to transfer assets from Earn to Custody, even if it would not allow customers to withdraw assets from Celsius.

Primarily as a result of the delay in funding the Custody wallets, Celsius's Custody assets were in a deficit position as of June 28, 2022. On that day, beginning with transfers of assets worth approximately \$47.9 million, Celsius began moving coins into the Custody wallets. By the time it filed bankruptcy, the deficit in the Custody wallets had largely been erased. But following Celsius's bankruptcy filing on July 13, 2022, this deficit returned and as of October 28,

2022, there was a deficit of approximately 3.2 million coins (\$16.9 million) in the Custody wallets.

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This investigation revealed that Celsius reacted to the regulatory scrutiny by launching its Custody program without sufficient accounting and operational controls or technical infrastructure. The Custody accounts did not regularly reconcile with assets held in the Custody wallets; shortfalls in the Custody wallets were funded by the Main wallets, where Earn deposits and other crypto assets were held; and no effort was made to segregate or separately identify any assets associated with the Withhold accounts, which were commingled in the Main wallets. As a result, customers now face uncertainty regarding which assets, if any, belonged to them as of the bankruptcy filing.

### **III. Investigative Steps**

The Examiner engaged in an extensive investigation of the topics addressed in this Interim Report. As described below, the Examiner collected a large volume of data and records, formally interviewed 17 current and former Celsius personnel and customers, and engaged in numerous information-gathering discussions with the various interested parties, including Celsius customers, Celsius, the Unsecured Creditors' Committee, state and federal regulatory agencies, and the *ad hoc* committees.

#### **A. Data And Record Collection From The Debtors**

During the examination to date, Celsius, through their counsel Kirkland & Ellis and financial advisors Alvarez & Marsal Consulting, provided the

Examiner with various categories of data and records responsive to the Examiner's requests. In summary, these materials, relied on by the Examiner in preparing this Interim Report, included:

- Celsius organizational charts.
- Celsius product development documents, policies, and procedures, including drafts.
- Celsius Customer Terms of Use.
- Financial and coin reports used by Celsius in its ordinary course of business.
- Reports from Celsius's Fireblocks workspaces.
- Emails and Slack channels in use at Celsius relevant to Interim Report topics.
- Wallet and Asset mapping documents.
- Materials provided by Celsius to state regulatory bodies.
- Investor presentations/decks and Risk and Asset & Liability Committee Meeting Minutes.
- Documents related to transactions on select exchanges.
- Marketing and communications documents.

The Examiner's efforts to collect information, however, were met with several limitations, including delays in the production of the necessary documents. Documents or information responsive to certain requests were not received until days prior to the filing of this Interim Report, and some were not received at all, which may require the Examiner to further supplement the information contained in this Interim Report when she issues her Final Report. Celsius's counsel was transparent with the Examiner and reported multiple reasons for the delays, including the reduction in Celsius's workforce.

In addition, Celsius imposed limitations on interviews of its employee witnesses, including by requesting that the Examiner preview any topics to be covered during the interviews and limiting the time of many interviews to two hours. Further, Celsius claimed privilege over communications between Celsius and the regulators, further limiting her ability to obtain the full scope of relevant facts.

**B. Data And Record Collections From Other Parties**

The Examiner received additional data and records from the United States Trustee, state regulatory agencies, and the Unsecured Creditors Committee.

**C. Witness Interviews**

Counsel for the Examiner has interviewed 17 individuals regarding the topics covered in this Interim Report, including 10 current and former Celsius personnel who work or worked in Custody Operations, Custody Innovation, Marketing, Business Processes/Controls, Revenue, Compliance, Engineering, and Treasury.<sup>10</sup> Counsel for the Examiner also interviewed two customers with Withhold Accounts and five customers with Custody Accounts. Several witnesses declined to be interviewed or did not respond to our requests for interviews.

**D. Huron Consulting Group**

On October 10, 2022, the Examiner engaged Huron Consulting Group to serve as her financial advisor.<sup>11</sup> Huron analyzed internal company financial

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<sup>10</sup> This Report includes quotes from contemporaneous interview notes. Although every effort was made to be accurate, these are not official verbatim transcripts.

<sup>11</sup> See Order Authorizing Employment of Huron Consulting Services LLC as Financial Advisor for the Examiner Effective as of October 10, 2022, dated November 1, 2022 [Dkt. 1262].

documents, Fireblocks transactional information, and public Blockchain data to understand Celsius’s business operations, its Earn and Custody account programs, and its use of the Withhold designation for certain customer accounts. Using primary source data, including what are known as Freeze Reports, Coin Reports, and Reconciliation Reports (all described further herein), and publicly sourced information, Huron developed charts, tables, and graphs that depict how Celsius held, deployed, and generally moved crypto assets. Huron’s review of Celsius’s documents and its analysis of coin deployment, movement, and storage supports the topics addressed in this Interim Report.

#### **IV. Background**

##### **A. A Summary Explanation Of Crypto Assets.**

###### **1. Crypto Assets**

Crypto assets, often referred to as “crypto” or “crypto currency,” are a form of currency that only exists digitally.<sup>12</sup> Unlike U.S. dollars, which are backed by the U.S. government (known as fiat currency), digital assets do not require government backing and do not rely on the traditional banking system to verify transactions. Instead of being governed by a government central authority (such as the U.S. Federal Reserve Bank), digital assets are governed by users and are thus considered “decentralized.” This user-based “peer-to-peer” system enables anyone, anywhere, to send and receive payments digitally without the involvement of a traditional financial institution. Proponents of digital assets

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<sup>12</sup> The terms “digital asset,” “crypto asset,” “cryptocurrency,” and “virtual currency” are often used interchangeably.

contend that the decentralized nature of this system is more efficient and reduces the risk of corruption and government overreach.

Crypto assets received the name because they use encryption, known as cryptography, to verify transactions. Advanced computer software is required to store and transmit digital asset data between digital wallets and to digital public ledgers (the blockchain), as explained below. The aim of encryption is to provide security and safety.

## **2. The Blockchain**

Crypto asset transactions are verified and recorded on a digital public ledger known as the blockchain, which functions as an online database that stores records of specific digital transactions. Crypto asset payments exist purely as digital entries on the blockchain. Blocks in the chain are created when crypto asset transactions are verified and recorded in sequential time-stamped batches. The crypto assets at issue in this Report reside on public blockchains, for which the entire history of digital transactions is visible to anyone.

There are many different blockchains and they do not all function the same way. Two primary blockchain architectures are relevant to this Report, explained in more detail below: (i) those that use an “unspent transaction” or “UTXO” model, such as Bitcoin; and (ii) those that use an “account-based” model, such as Ethereum. This distinction impacts how different crypto assets on each blockchain are transferred, tracked, and held.<sup>13</sup>

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<sup>13</sup> The extent to which particular crypto assets are traceable from transfer to transfer depends on the type of blockchain. With account-based blockchains like Ethereum, there is no way to identify which inbound deposit correlates to any particular outbound

Some digital assets like Bitcoin and Ether are native to their own blockchain, but not every crypto asset has its own blockchain. Certain blockchains also enable users to create new crypto assets on that blockchain, so that one blockchain can host many different crypto assets.<sup>14</sup> Many of the assets at issue in this Report, including the CEL token, reside on the Ethereum blockchain.

### **3. Public-Private Key Cryptography**

For both UTXO and account-based blockchains, transfers on the blockchain take place between publicly-visible blockchain digital addresses that appear as a seemingly random string of letters and numbers, such as bc1q2ye2gzrh9utdtdu54cchufm2g8nu29t3ghvgw6. These blockchain addresses are generated and secured with a form of cryptography known as public-private key cryptography. The digital address visible on a public blockchain is derived from the public key, and that digital address and public key can be shared with anyone (and must be shared for others to send *to* that address, like sharing an e-mail address). Each public key is derived from and paired with a private key, which functions like a password. To execute a transaction transferring cryptocurrency *from* a public address, one must enter the private key associated

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transfer. With UTXO blockchains, like Bitcoin, it is theoretically possible to trace an incoming deposit to a particular outbound transfer, but the transfer process takes place behind the scenes in automated software, and so any correlation between any user's deposit and any particular subsequent transfer would be coincidental.

<sup>14</sup> Crypto assets native to a blockchain, such as Bitcoin on the Bitcoin blockchain and Ether on the Ethereum blockchain, are known as "coins." Crypto assets issued on top of existing networks, such as the CEL token issued on the Ethereum blockchain, are known as "tokens." The distinction between coins and tokens is not relevant to this Report.

with that particular address.<sup>15</sup> Thus, control of the private key determines control of the crypto assets at the associated public blockchain address. In the market for crypto assets, “custody” typically refers to holding private keys on behalf of customers.<sup>16</sup>

A person or entity holding private keys (whether for themselves or on behalf of others) typically deploys one or more technology products and/or security services to assist in holding and managing the private keys. These solutions range from a simple software “wallet” that stores the private keys and keeps track of the blockchain addressee, to hardware that allows the private keys to be maintained offline (referred to as “cold storage” if disconnected from the Internet). In addition, numerous third-party services offer enhanced security solutions.

#### **B. The Nature Of The Crypto Assets Held By Celsius.**

Celsius held dozens of different types of crypto assets. For purposes of this Report, we discuss the movement of Celsius’s crypto assets in five broad categories:<sup>17</sup>

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<sup>15</sup> Most blockchains also support multi-signature functionality, in which a single address would have multiple private keys necessary to effect a transaction, equivalent to needing to use two keys to open a vault.

<sup>16</sup> See, e.g., Office of the Comptroller of the Currency, Interpretive Letter #1170, OCC, at 5 (July 22, 2020), <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf> (“Therefore, a bank ‘holding’ digital currencies on behalf of a customer is actually taking possession of the cryptographic access keys to that unit of cryptocurrency.”) (last visited Nov. 19, 2022).

<sup>17</sup> See Appendix A, Schedule 3 for a mapping of crypto assets held by Celsius with respect to each of these categories during this time.

## **1. Bitcoin (BTC)**

Bitcoin (BTC) is the most well-known digital asset. It is the native token for the Bitcoin blockchain, which was introduced with the publication of a white paper in 2008 and is generally considered the first blockchain.<sup>18</sup> The Bitcoin blockchain network is designed to perform a single function: record transfers of BTC, which it does by maintaining an unalterable distributed ledger of transactions.<sup>19</sup> The Bitcoin blockchain uses a UTXO protocol to track the BTC movement on the Bitcoin blockchain. In short, a UTXO is a digital ledger entry for crypto assets not yet spent, and a user's digital wallet balance is calculated from the aggregation of UTXOs. Bitcoin wallet software automates this process to facilitate transactions and display the aggregate balance, so users typically do not see the UTXO process.

## **2. Ether (ETH)**

Ethereum is the second largest blockchain and has a native cryptocurrency known as Ether (ETH). In order to use the Ethereum blockchain, the user must spend ETH as “gas” to pay for each transaction they initiate on the Ethereum blockchain.

Unlike Bitcoin, the Ethereum blockchain uses an account-based model. In the account-based model, the aggregate balance of ETH held at each Ethereum blockchain address is kept as a ledger, so that when a user transfers ETH from one address to another, the total ledger balance of each address is

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<sup>18</sup> See Nakamoto, Satoshi, Bitcoin: A Peer-to-Peer Electronic Cash System, <https://bitcoin.org/bitcoin.pdf>.

<sup>19</sup> *Id.* at 2-3.

adjusted accordingly. Unlike in the UTXO model, users in the account-based model cannot trace inbound transactions to outbound transactions—the outbound transaction updates the aggregate account balance stored on the Ethereum blockchain, without identifying any particular inputs.

The Ethereum blockchain also provides a mechanism for users to participate in the process of generating new blocks by “staking” (effectively locking up) ETH tokens.<sup>20</sup> By staking, users receive a portion of the fees (currently 4.4% APR) captured by the creators of each new block.<sup>21</sup>

Many users (including Celsius) stake ETH through a third party, Lido.<sup>22</sup> In exchange for staking ETH with Lido, the user receives an equivalent amount of a separate token, “stETH,” intended to function as a claim check for the staked ETH.<sup>23</sup>

At present, it is not possible to “unstake” ETH, but the ability to unstake is planned for a future upgrade of the Ethereum network.<sup>24</sup> If that planned upgrade takes place (at a yet-to-be-determined point in the future), users will be able to unstake ETH by exchanging their stETH for ETH. As a result, stETH has a theoretical value equivalent to ETH. However, with no present ability to unstake, the only way to exchange stETH for ETH is in the secondary market,

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<sup>20</sup> How to Stake Your ETH, Ethereum (last visited November 18, 2022), <https://ethereum.org/en/staking/>.

<sup>21</sup> See *id.*

<sup>22</sup> Stake with Lido, Lido (last visited November 18, 2022), <https://stake.lido.fi/>.

<sup>23</sup> See *id.*

<sup>24</sup> Discussion Forum for the Planned Ethereum “Shanghai” Upgrade, Github (last visited November 18, 2022), <https://github.com/ethereum/pm/issues/450> (holding a discussion forum for the planned Ethereum “Shanghai” upgrade).

where stETH trades at a discount to ETH.<sup>25</sup> As discussed further below, Celsius’s internal accounting reflects stETH as an “ETH Equivalent.”

### **3. Celsius’s Token (CEL)**

The CEL token does not have its own blockchain; it is an ERC-20 token on the Ethereum blockchain.

The Ethereum blockchain is more complex than the Bitcoin blockchain and does much more than just record transfers of ETH. It also functions as a decentralized computer, enabling users to upload computer code to the blockchain so that all users can access the code and operate it as a form of decentralized application (akin to running “apps” on a cellphone, except that the apps are stored and operated on the public Ethereum blockchain network).<sup>26</sup> These programs, often referred to as “smart contracts,” can be used to automate a series of transactions or to perform more complex functions.<sup>27</sup>

One early smart contract on the Ethereum blockchain contained a template of computer code for users to create their own cryptocurrency tokens and record transactions involving their new tokens by deploying that code on the Ethereum blockchain. The template was published as a proposal with a request for comment (Ethereum request for comment number 20, or “ERC-20”).<sup>28</sup> The proposed ERC-20 template made creating new tokens easy (an experienced user

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<sup>25</sup> See Lido Staked ETH, CoinMarketCap (last visited November 18, 2022), <https://coinmarketcap.com/currencies/steth/steth/eth/>.

<sup>26</sup> Ethereum Virtual Machine (EVM), Ethereum (last visited November 18, 2022), <https://ethereum.org/en/developers/docs/evm/>.

<sup>27</sup> See *id.*

<sup>28</sup> ERC: Token Standard #20, Github (last visited November 18, 2022), <https://github.com/ethereum/EIPs/issues/20>.

can launch a new ERC-20 token in minutes), and the template served as a standard so that any crypto assets created using that template would be compatible with each other. All ERC-20 tokens could be sent to or from standard Ethereum blockchain addresses, and any wallet, exchange, or other software made to interact with ERC-20 tokens could easily interact with any token adopting that standard. Since then, thousands of tokens have been created using the ERC-20 standard.<sup>29</sup> CEL is an ERC-20 token deployed on the Ethereum blockchain.<sup>30</sup> There are thousands of other ERC-20 tokens, including many of the crypto assets held by Celsius and addressed below.

#### **4. Stablecoins (USDC, USDT, PUSD)**

In addition to BTC, ETH, and CEL, Celsius held a number of stablecoins. Stablecoins are crypto assets designed to maintain a stable price pegged to an underlying asset (most commonly, the U.S. Dollar). For U.S. Dollar stablecoins, each token is intended to maintain a value of \$1.00, typically by holding (or purporting to hold) reserves of cash or cash equivalents so that each token is backed 1-to-1 by actual U.S. dollar assets.<sup>31</sup> Multiple companies have issued U.S. Dollar stablecoins, including USD Coin (“USDC”),<sup>32</sup> Tether (“USDT”),<sup>33</sup> and

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<sup>29</sup> See, e.g., Castor, Amy, Ethereum Tokens Are All the Rage. But What Are They Anyway? (June 17, 2017, updated September 11, 2021), <https://www.coindesk.com/markets/2017/06/17/ethereum-tokens-are-all-the-rage-but-what-are-they-anyway/>.

<sup>30</sup> Blockscan Chat Wallet-to-Wallet Instant Messaging Platform, Etherscan (last visited November 18, 2022), <https://etherscan.io/token/0xaaaeb6fe48e54f431b0c390cfaf0b017d09d42d#code>.

<sup>31</sup> Celsius made no distinction between the treatment of stablecoins versus any other digital asset under its Terms of Use or in its deployment or treatment of the coin.

<sup>32</sup> Crypto That’s Held to a Higher Standard, Circle (last visited November 18, 2022), <https://www.circle.com/en/usdc>.

<sup>33</sup> Tether Token, Tether (last visited November 18, 2022), <https://tether.to/en/>.

Pax Dollar (“USDP”).<sup>34</sup> Each of these examples is an ERC20 token on the Ethereum blockchain.

### **5. Other Digital Assets (*i.e.*, ADA, DOT, LTC)**

The majority of Celsius’s crypto assets were BTC, ETH, CEL, and stablecoins. However, Celsius also held scores of other crypto assets—a mix of ERC-20 tokens on the Ethereum blockchain, and tokens operating on their own or other blockchains. For example, Celsius held Litecoin (LTC), Bitcoin Cash (BCH), and Dash (DASH), which are separate blockchains derived from the Bitcoin code base and which use a similar UTXO model. Celsius also held Cardano (ADA) and Polkadot (DOT), which are coins on their own blockchains using an account-based model similar to Ethereum. In aggregate, all of these other digital assets comprised a relatively small portion of Celsius’s total crypto assets. The custody and movement of each of these crypto assets is accounted for below, but for purposes of discussion they are grouped into an “other” category.

### **6. Centralized Finance (“CeFi”) and Decentralized Finance (“DeFi”)**

As discussed above, the Ethereum blockchain functions as a virtual machine capable of running computer programs, often referred to as smart contracts. The ERC20 template is an example of a simple smart contract for creating and tracking a token.

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<sup>34</sup> Pax Dollar, Paxos (last visited November 18, 2022), <https://paxos.com/usdp/>.

Over time, smart contracts have been deployed to automate more complex financial transactions such as exchanging, borrowing, and lending digital assets. The services enabled by smart contracts performing financial transactions on decentralized blockchains are often collectively referred to as decentralized finance, or “DeFi.”<sup>35</sup>

### **7. Wrapped Tokens (*i.e.*, WBTC, wETH)**

Many DeFi platforms are designed to operate with ERC-20 tokens. To use tokens other than ERC-20 on those DeFi platforms, one must exchange the non-ERC-20 token for a financially equivalent ERC-20 token, otherwise known as a “wrapped” token. For example, a wrapped Bitcoin (“WBTC”) is an ERC20 token pegged to the value of Bitcoin, and supported by a reserve of Bitcoin.<sup>36</sup> As discussed further below, Celsius’s internal accounting reflects WBTC as a “BTC Equivalent,” and wETH as an “ETH Equivalent.”

### **C. Celsius’s Control And Custody Of Crypto Assets**

Celsius held and managed its private keys using a security solution and software service provided by Fireblocks.<sup>37</sup> Fireblocks offers its customers a

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<sup>35</sup> DeFi should not be confused with the myriad centralized entities that offer financial services of one kind or another related to crypto assets. Platforms that enable borrowing and lending, such as Celsius, and centralized exchanges such as Coinbase, are not DeFi even though they involve crypto assets, because they are operated by centralized companies and are not automated software operating on decentralized public blockchain networks.

<sup>36</sup> WBTC is created using intermediaries and custodians to hold the BTC and issue the WBTC, WBTC (last visited November 18, 2022), <https://wbtc.network/>, while wETH is managed by a smart contract that automatically issues wETH in response to receiving ETH and returns ETH in response to receiving wETH, *see* Token Wrapped Ether, Etherscan (last visited November 18, 2022), <https://etherscan.io/token/0xc02aaa39b223fe8d0a0e5c4f27ead9083c756cc2#code>.

<sup>37</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 6, 2022).

private key security solution known as multi-party computation, or MPC, through which the private key is broken up into shares, encrypted, and divided among multiple parties.<sup>38</sup> Fireblocks' software assists in managing and securing the private keys, including storing some encrypted shares of the private keys and facilitating the signing of transactions using those private keys. It leaves custody of the private keys in the hands of its customers, however, in that Fireblocks cannot access the entire private key, and customers have the sole ability to consummate a transaction and the sole responsibility for a back-up of their private keys necessary to recover the wallets (and which would enable the user to access the wallets outside of Fireblocks and transition to another provider).

#### **D. Celsius's Founding And Business Model**

Celsius Network Limited was formally incorporated in February 2018.<sup>39</sup> By Celsius's own account, it was originally conceived in the summer of 2017 when its founders Alex Mashinsky and S. Daniel Leon first "sketched out their plan for Celsius on a coffee shop napkin."<sup>40</sup> Celsius launched its platform in March 2018, and it released the first version of its mobile application in June of that year.<sup>41</sup> Celsius adopted the slogan "Unbank yourself," and it advertised that customers could "[d]eposit coins" onto Celsius's platform and then "[b]orrow dollars against"

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<sup>38</sup> What is MPC (Multi-Party Computation)?, Fireblocks (last visited November 18, 2022), <https://www.fireblocks.com/what-is-mpc/>.

<sup>39</sup> Celsius Network Limited, Certificate of Incorporation of a Private Limited Company (February 9, 2018).

<sup>40</sup> About Us, Celsius (November 9, 2022), <https://celsius.network/about-us>.

<sup>41</sup> *Id.*; Mashinsky Decl, ¶¶ 7, 37.

or “[e]arn interest” on their deposited crypto.<sup>42</sup> From its inception until April 14, 2022, Celsius’s primary product offering was its “Earn” program.<sup>43</sup>

As of July 13, 2022 (the “Petition Date”), when it filed for Chapter 11 bankruptcy, Celsius reporting holding \$4.3 billion in assets and reported \$5.5 billion in liabilities, primarily to its customers.<sup>44</sup>

#### **E. The “Earn” Program**

The Earn program, as discussed above, enabled customers to deposit crypto assets into an account held by Celsius. Once a customer deposited crypto assets into an Earn account, Celsius “deployed” a portion of those assets in various ways to generate revenue for Celsius.<sup>45</sup> For example, Celsius loaned BTC and other assets to institutional borrowers, staked assets such as ETH, and deployed other assets in DeFi protocols to obtain yield for deposits.<sup>46</sup>

Celsius solicited Earn customers by offering “rewards” on Celsius-supported crypto asset deposits. These rewards took the form of weekly interest payments, rates of which Celsius set, published on its platform, and periodically adjusted.<sup>47</sup> Celsius customers generally could elect to receive rewards in one of

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<sup>42</sup> Home, Wayback Machine, Celsius (June 9, 2018), <https://celsius.network/>.

<sup>43</sup> Examiner Interview of Roni Cohen-Pavon (Chief Revenue Officer – Celsius, November 15, 2022); Examiner Interview of Katie Osadetz (Senior Manager Product Planning – Celsius, November 16, 2022).

<sup>44</sup> Mashinsky Dec. ¶16 (July 14, 2022).

<sup>45</sup> As stated in its Terms of Use, Celsius could “pledge, re-pledge, hypothecate, rehypothecate, sell, lend, or otherwise transfer or use any amount of such Digital Assets.” Mashinsky Terms of Use Decl. at Ex. A-2, §14 (March 5, 2020).

<sup>46</sup> Examiner Interview of Roni Cohen-Pavon (Chief Revenue Officer – Celsius, November 15, 2022).

<sup>47</sup> According to the Celsius Terms of Use, digital assets were eligible for rewards only if they: (1) were not being used as collateral for loans, (2) were not transferred to another

two ways: (1) “in-kind,” meaning in the form of the same crypto asset the customer had deposited with Celsius; or (2) in CEL,<sup>48</sup> an ERC-20 token Celsius created in March 2018.<sup>49</sup> CEL rewards carried higher interest rates; but, according to Chief Revenue Officer Roni Cohen-Pavon, Celsius intended to “lock” CEL rewards for a one-year period and not let customers withdraw or swap CEL during that time.<sup>50</sup> Attached as Appendix B is an example (from January 2022) of how Celsius posted its rewards on its website.

#### **F. Celsius’s Wallet Structure**

To transfer assets into the Earn program, customers sent crypto assets from an outside source (such as another digital wallet they controlled, or from an account at an exchange) to a blockchain address Celsius provided for the deposit. The deposit was reflected almost immediately in the customer’s Celsius account, and the account was updated weekly to reflect the addition of rewards at the then-posted rate. To withdraw assets (up until June 2022, when withdrawals were paused), the customer specified a destination blockchain address to which the assets should be transferred; from the customer’s perspective, the assets were sent to the specified address, and concurrently deducted from the customer’s Celsius account.

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Celsius user, and (3) were not requested for external transmission. Mashinsky Terms of Use Decl. at Ex. A-2, §14 (March 5, 2020).

<sup>48</sup> Celsius Networks, General Terms of Use (July 22, 2021).

<sup>49</sup> The ability to earn CEL as a reward for non-CEL tokens first became available in January 2022, and was limited to non-U.S. customers and certain accredited U.S. investors.

<sup>50</sup> The Examiner’s analysis of the CEL token is ongoing, and not within the scope of this Report.

The internal process at Celsius was more complicated. Celsius created a unique blockchain address (called a “bridge” wallet) for each customer and for each type of deposited asset. A customer was assigned more than one bridge wallet if she deposited crypto assets on different blockchains (*e.g.*, Ethereum wallet for ETC and ERC-20 token deposits, and a Cardano wallet for deposits of that blockchain’s native token). Celsius owned these wallets and used them to identify the customer and her deposit history when receiving deposits.<sup>51</sup>

Typically soon after a customer deposited her crypto assets in her individual bridge wallet, Celsius “swept” into one of Celsius’s commingled wallets, known as “aggregator” or “Main” wallets.<sup>52</sup> As a general matter, there was a single commingled wallet for each asset type, so, for example, all ETH and ERC-20 assets were swept into a single aggregator wallet on the Ethereum blockchain and all ADA was swept into a single wallet on the Cardano blockchain.<sup>53</sup> The crypto assets in these aggregator wallets were considered part of “Treasury” at Celsius and, subject to a liquidity reserve, the assets in Treasury were considered available for Celsius to deploy to generate revenue, such as for institutional lending or to DeFi protocols.<sup>54</sup>

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<sup>51</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>52</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>53</sup> There were multiple co-mingled Bitcoin wallets, as discussed further below.

<sup>54</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

In other words, while each customer's account reflected the specific number of each asset deposited (plus rewards), Celsius did not have a specific wallet holding the specific assets the customer had deposited. Consequently, when a customer sought to withdraw assets off the Celsius platform, Celsius effectuated the withdrawal by transferring assets from a set of commingled wallets referred to as "frictional" wallets<sup>55</sup> to the customer's specified external wallet. The frictional wallets were not unique to each user and were pre-funded to facilitate transfers directly to multiple customers. If the frictional wallets contained insufficient assets to satisfy withdrawal needs, additional assets were moved from Main wallets to the frictional wallets. But ultimately, all of the crypto assets that Celsius transferred to customers when customers made withdrawals came from a frictional wallet.<sup>56</sup>

According to Celsius, beginning in late 2019, all of the crypto assets under Celsius's control and not pledged as collateral or on deposit at an exchange, were maintained using the Fireblocks platform.<sup>57</sup> Fireblocks enabled Celsius to establish one or more "workspaces" to manage crypto asset blockchain addresses. Celsius maintained multiple workspaces, each with its own permissions. These permissions determined access to that workspace, and imposed limitations on the use or transfer of assets from that workspace.<sup>58</sup> The

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<sup>55</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

<sup>56</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

<sup>57</sup> Celsius, UCC-CL Request – Security, at 1-3 (July 30, 2022).

<sup>58</sup> Examiner Interview of Nuke Goldstein (Former Chief Technology Officer – Celsius, November 17, 2022).

following is a list of Celsius's workspaces as of the Petition Date, pulled from Celsius's internal wallet list:

Workspace Name
Celsius - Custody Production
Celsius – Playground
Celsius DeFi (US)
Celsius Mining (US)
Celsius Network EU UAB (LT)
Celsius Network Finance
Celsius Network Limited (UK)
Celsius Network LLC (US)
Celsius OTC

All assets held by Celsius as part of its Custody program were held in the various wallets (by coin type) in the “Custody Production” workspace. The “Playground,” “DeFi,” and the four “Celsius Network” workspaces were all a part of Celsius’s Treasury, meaning the assets in the wallets in those workspaces were available for Celsius’s general deployment activities.

## **V. Celsius’s Creation Of Custody Accounts**

### **A. Celsius’s Creation Of Its Custody Program**

From its inception, Celsius’s Earn program was its primary customer product and the focus of its marketing efforts.<sup>59</sup> On April 11, 2022, Celsius announced a fundamental change to its business model effective April 15, 2022: the launch of its self-styled “Custody Solution.” The hallmarks of this new

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<sup>59</sup> Examiner Interview of Roni Cohen-Pavon (Chief Revenue Officer – Celsius, November 15, 2022); Celsius Networks, GTM Brief (April 23, 2022) CEL\_EXAM-00010222 (“Celsius’ core product has always been our traditional lending services that generates yield for customers who bring their crypto to our platform.”); Examiner Interview of Katy Osadetz (Senior Manager Product Planning – Celsius, November 16, 2022).

Custody offering, as explained by Celsius in its initial public communications on the subject, were as follows:

1. That “[a]ll coins transferred to Celsius by users in the United States prior to April 15, 2022, will continue to earn rewards. Those existing coins will continue to earn rewards for as long as they remain in their Earn accounts.”<sup>60</sup>
2. “On April 15, 2022, Celsius will be launching a new Custody solution for users in the United States. Custody will serve as the centerpiece of your home for crypto, providing a secure way to navigate across Celsius’ products, including store, access, borrow, spend, earn and grow.”<sup>61</sup>
3. “New transfers made by non-accredited investors in the United States will be held in their new Custody accounts and will not earn rewards. Non-accredited investors can continue to swap, borrow, and transfer within their Custody accounts based on their local jurisdiction.”<sup>62</sup>
4. “Verified accredited investors in the United States will be able to add new coins into their Earn accounts, where they will continue to earn rewards.”<sup>63</sup>
5. “Users located outside of the United States will be unaffected by these changes. They will continue to have access to all of the products and services available to them prior to these changes.”<sup>64</sup>
6. In a footnote, Celsius stated that that “users in some US jurisdictions will not have access to the Custody service at this point due to local licensing requirements.”<sup>65</sup> This subset of users, who would come to be known as Celsius’s “withhold” customers is discussed in more detail in Section VI.

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<sup>60</sup> Important Celsius Update for Our Users in the United States, Celsius (April 11, 2022), <https://celsiusnetwork.medium.com/important-celsius-update-to-our-us-clients-6df471420cc7>.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

**B. Regulatory Scrutiny Of Celsius And Others In The Crypto Industry Were A Major Factor In The Decision To Create Custody And Withhold Accounts.**

The Custody program went into effect on April 15, 2022, but its genesis can be traced back to May 2021, when multiple state securities regulators began investigating the Earn program, on suspicion that Celsius was offering an unregistered security in violation of state laws.<sup>66</sup> Beginning in May 2021, regulators in New Jersey,<sup>67</sup> Texas,<sup>68</sup> and Kentucky<sup>69</sup> served Celsius with document requests. By August 2021, four more states—Arkansas,<sup>70</sup> Oklahoma,<sup>71</sup> Pennsylvania,<sup>72</sup> and Washington<sup>73</sup>—plus the U.S. Securities and

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<sup>66</sup> Debtors' counsel advised the Examiner that Celsius sought to engage cooperatively with regulators in pursuit of a global settlement, and has taken the position that communications in furtherance of that engagement qualify as confidential settlement discussions.

<sup>67</sup> New Jersey Office of the Attorney General, Bureau of Securities, Letter re: Celsius Network Limited, Its Parents, Subsidiaries, or Affiliates, Including the Rewards Program (May 14, 2021), CEL-UCC-00068302; *see also* Letter from Celsius Responding to New Jersey Bureau of Securities (Aug. 9, 2021), CEL-UCC-00023190.

<sup>68</sup> Texas State Securities Board, Letter re: Interest-Bearing Cryptocurrency Deposit Accounts (May 14, 2021), CEL-UCC-00068050; Letter from Celsius Responding to Texas State Securities Board (June 11, 2021), CEL-UCC-00023339.

<sup>69</sup> Kentucky Public Protection Cabinet, Department of Financial Institutions, Letter re: Celsius Network Limited/Case #392023 (May 26, 2021), CEL-UCC-00068304; Letter from Celsius Responding to Kentucky Public Protection Cabinet (July 16, 2021), CEL-UCC-00023248.

<sup>70</sup> Arkansas Securities Department, Letter to Celsius Network (June 25, 2021), CEL-UCC-00068314.

<sup>71</sup> State of Oklahoma, Department of Securities, Letter re: Request for Information (July 27, 2021), CEL-UCC-00068978; Letter from Celsius Responding to Oklahoma Department of Securities (Oct. 1, 2021), CEL-UCC-00018300.

<sup>72</sup> Pennsylvania Department of Banking and Securities, Letter re: Celsius Network, LLC Docket #2021-08-004 (August 24, 2021), CEL-UCC-00068066; Letter from Celsius Responding to Pennsylvania Department of Banking and Securities (Docket No. 2021-08-004) (September 17, 2021), CEL-UCC-00023296.

<sup>73</sup> State of Washington, Department of Financial Institutions Securities Division, Letter re: Celsius Network Limited, Celsius Network LLC (DFI No. 54192) (July 29, 2021), CEL-

Exchange Commission (“SEC”)<sup>74</sup> had served Celsius with requests for documents or subpoenas. And by mid-September 2021, two states had announced cease-and-desist actions against Celsius in relation to its Earn accounts: New Jersey<sup>75</sup> and Kentucky.<sup>76</sup> Following these actions, Celsius received demands for additional documents from Alabama,<sup>77</sup> Pennsylvania,<sup>78</sup> and the SEC,<sup>79</sup> and new requests from regulators in Massachusetts and New York.<sup>80</sup> Texas filed and served a hearing notice related to its formal request to a state court to enforce a

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UCC-00068056; Letter from Celsius Responding to Washington Securities Division (Aug. 31, 2021), CEL-UCC-00023264.

<sup>74</sup> Securities and Exchange Commission, Letter re: In the Matter of Certain Digital Asset Lending Platforms, HO-14301 (July 23, 2021), CEL-UCC-00068085; Letter from Celsius Responding to SEC (Aug. 23, 2021), CEL-UCC-00022923.

<sup>75</sup> New Jersey Bureau of Securities Orders Cryptocurrency Firm Celsius to Halt the Offer and Sale of Unregistered Interest-Bearing Investments, New Jersey Office of the Attorney General (September 17, 2021), <https://www.njoag.gov/new-jersey-bureau-of-securities-orders-cryptocurrency-firm-celsius-to-halt-the-offer-and-sale-of-unregistered-interest-bearing-investments/#:~:text=Celsius%20and%20similar%20companies%20are,the%20Federal%20Deposit%20Insurance%20Corporation>; State of New Jersey, Bureau of Securities, Summary Cease and Desist Order (September 17, 2021), <https://www.nj.gov/oag/newsreleases21/Celsius-Order-9.17.21.pdf>.

<sup>76</sup> Emergency Order to Cease and Desist, Kentucky Department of Financial Institutions (September 23, 2021), <https://kfi.ky.gov/Documents/Celsius%20Network%20LLC%202021AH00024.pdf>. Kentucky issued an emergency order to cease and desist against Celsius. This resulted in Celsius ceasing to accept deposits from Kentucky residents on October 12, 2021. Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>77</sup> Letter from Alabama Securities Commission to Celsius (Sept. 13, 2021), CEL-UCC-00068318 (No custodian listed); Letter from Celsius Responding to Alabama Securities Commission (Oct. 7, 2021), CEL-UCC-00000142.

<sup>78</sup> Letter from Celsius Responding to Pennsylvania Bureau of Securities Compliance and Examinations (Feb. 14, 2022), CEL-UCC-00022765.

<sup>79</sup> Letter from Celsius Responding to SEC (Nov. 3, 2021), CEL-UCC-00023024; Letter from Celsius Responding to SEC (Dec. 3, 2021), CEL-UCC-00023040; Letter from Celsius Responding to SEC (Jan. 18, 2022), CEL-UCC-00023043.

<sup>80</sup> Letter from Celsius Responding to Massachusetts Securities Division (Oct. 29, 2021), CEL-UCC-00004650; Letter from Celsius Responding to New York State Attorney General (Nov. 1, 2021), CEL-UCC-00015723.

cease-and-desist order against Celsius.<sup>81</sup> Washington state also filed a “statement of charges” that has been continued indefinitely.<sup>82</sup>

At around the same time, federal and state regulators were pursuing a similar investigation of cryptocurrency lender and Celsius competitor BlockFi, in connection with its interest-bearing cryptocurrency lending product. In a July 19, 2021 cease-and-desist order, New Jersey deemed BlockFi’s lending product to be a security and, because it was unregistered, charged BlockFi with violating the Investment Company Act of 1940.<sup>83</sup> Yarden Noy, Celsius’s Head of Regulations, stated that Celsius closely followed and was influenced by the SEC’s actions against BlockFi.<sup>84</sup>

On February 14, 2022, the SEC announced a “first-of-its-kind” settlement with BlockFi. In a joint resolution, BlockFi paid a penalty of \$50 million to the SEC, agreed to cease offering the unregistered lending product, and paid an additional \$50 million in fines to resolve parallel actions in 32 states.<sup>85</sup>

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<sup>81</sup> Notice of Administrative Hearing, Texas State Securities Board (Sept. 17, 2021), [https://www.ssb.texas.gov/sites/default/files/2021-09/20210917\\_FINAL\\_Celsius\\_NOH\\_js\\_signed.pdf](https://www.ssb.texas.gov/sites/default/files/2021-09/20210917_FINAL_Celsius_NOH_js_signed.pdf).

<sup>82</sup> Examiner Interview with Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>83</sup> Summary Cease and Desist Order, New Jersey Bureau of Securities (July 19, 2021), <https://www.nj.gov/oag/newsreleases21/BlockFi-Cease-and-Desist-Order.pdf> (last visited Nov. 19, 2022).

<sup>84</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>85</sup> BlockFi Agrees to Pay \$100 Million in Penalties and Pursue Registration of its Crypto Lending Product, U.S. Securities and Exchange Commission (February 14, 2022), <https://www.sec.gov/news/press-release/2022-26>.

Following the BlockFi settlement, the SEC issued additional subpoenas to Celsius for records.<sup>86</sup> In response to the regulatory scrutiny, Celsius began developing its Custody product. According to Mr. Pavon, Celsius initially began thinking about Custody in August 2021, intending to ensure Celsius's continued viability in the U.S. if it could no longer offer Earn to unaccredited investors.<sup>87</sup> Mr. Pavon said that, at its inception, the decision to create Custody was driven "mostly about number and effect on growth."<sup>88</sup>

When Celsius publicly announced the Custody program on April 11, 2022, it stated,

As we have previously acknowledged, Celsius has been working closely with regulators around the world. It is our intention to be as transparent with our community as possible. More specifically, we have been in ongoing discussions with the United States regulators regarding our Earn product. As a result, there will be changes to the way our Earn product will work for users based in the United States.<sup>89</sup>

Juwon Layiwola, a Celsius director, explained that Celsius came up with the Custody product to enable Celsius to keep the assets on the platform and allow new users to create accounts but not run afoul of regulators.<sup>90</sup> Likewise, a former

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<sup>86</sup> CEL-UCC-00068132 (Subpoena from SEC to Celsius, Apr. 6, 2022); CEL-UCC-00068106 (Subpoena from SEC to Celsius, Jan. 19, 2022); Letter from Celsius Responding to SEC (Apr. 28, 2022), CEL-UCC-00023171.

<sup>87</sup> Examiner Interview of Roni Cohen-Pavon (Chief Revenue Officer – Celsius, November 15, 2022).

<sup>88</sup> Examiner Interview of Roni Cohen-Pavon (Chief Revenue Officer – Celsius, November 15, 2022).

<sup>89</sup> Important Celsius Update for our Users in the United States, Celsius (April 11, 2022), <https://celsiusnetwork.medium.com/important-celsius-update-to-our-us-clients-6df471420cc7>.

<sup>90</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

Celsius employee, who was in a leadership position (hereinafter referred to as “the former Celsius employee”), described the change as a “predominantly defensive play” to “keep the assets with us, retain some sort of relevance.”<sup>91</sup> And Oren Blonstein, Celsius’s former Head of Innovation and Chief Compliance Officer, commented that regulatory considerations were the “driving force”—although not sole factor—in Custody’s creation.<sup>92</sup> As Mr. Noy succinctly stated: “Given the regulators, we came up with Custody.”<sup>93</sup>

The New Jersey cease-and-desist order proved particularly impactful to Celsius’s business. While New Jersey agreed to extend the effective date of its order multiple times,<sup>94</sup> the existence of this deadline significantly impacted how Celsius was able to develop and implement its Custody program. The initial working title for the Custody program was “Custody First,”<sup>95</sup> and it was part of a series of other regulatory reforms known internally as “Project Phoenix.” Project

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<sup>91</sup> Examiner Interview (Former Employee – Celsius, November 3, 2022).

<sup>92</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer and Head of Innovation – Celsius, November 4, 2022).

<sup>93</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>94</sup> The initial deadline for the New Jersey cease-and-desist was November 1, 2021; on October 29, 2021, the New Jersey Bureau extended the effective date to December 10, 2021. State of New Jersey Bureau of Securities, Summary Cease and Desist Order-Second Extension, In the Matter of: Celsius Network, LLC (December 2, 2021). On December 6, 2021, the effective date was further extended to February 16, 2022. *Id.* Further extensions were granted to March 31, 2022, and finally April 15, 2022. Examiner Interview of Katy Osadetz (Celsius – Senior Manager of Product Planning, November 16, 2022).

<sup>95</sup> Celsius, Custody First PowerPoint (December 2021).

Phoenix covered four initiatives: Know-Your-Customer (KYC); Accredited Investors (AI); Restrictions;<sup>96</sup> and Custody.<sup>97</sup>

According to a December 2021 presentation prepared by David Ogilvy, the former Head of Custody Innovation, “Custody First” was to be “a neutral custody layer that will be out of scope for rehypothecation and yield (shall not [be] a security) that user crypto assets can be held in before transfer to a suitable product.”<sup>98</sup> One of the perceived benefits of Custody, as conceptualized, was that Celsius could “strategically [] offer [its] products in various jurisdictions and ... easily adjust the product offering to ensure we are in compliance with any local regulatory requirements.”<sup>99</sup> That is, “[a]ll retail deposits w[ould] go to the custody account first (‘Custody First’),”<sup>100</sup> making it “the key entry point product.”<sup>101</sup> Ogilvy’s December 2021 presentation illustrated the change in approach:<sup>102</sup>

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<sup>96</sup> “Restrictions” applied to those states where Celsius could not provide Earn or Custody programs (i.e., the Withhold States). Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>97</sup> Layiwola, Juwon, Email re: Project Phoenix: Introduction (January 13, 2022), CEL\_EXAM-000000274.

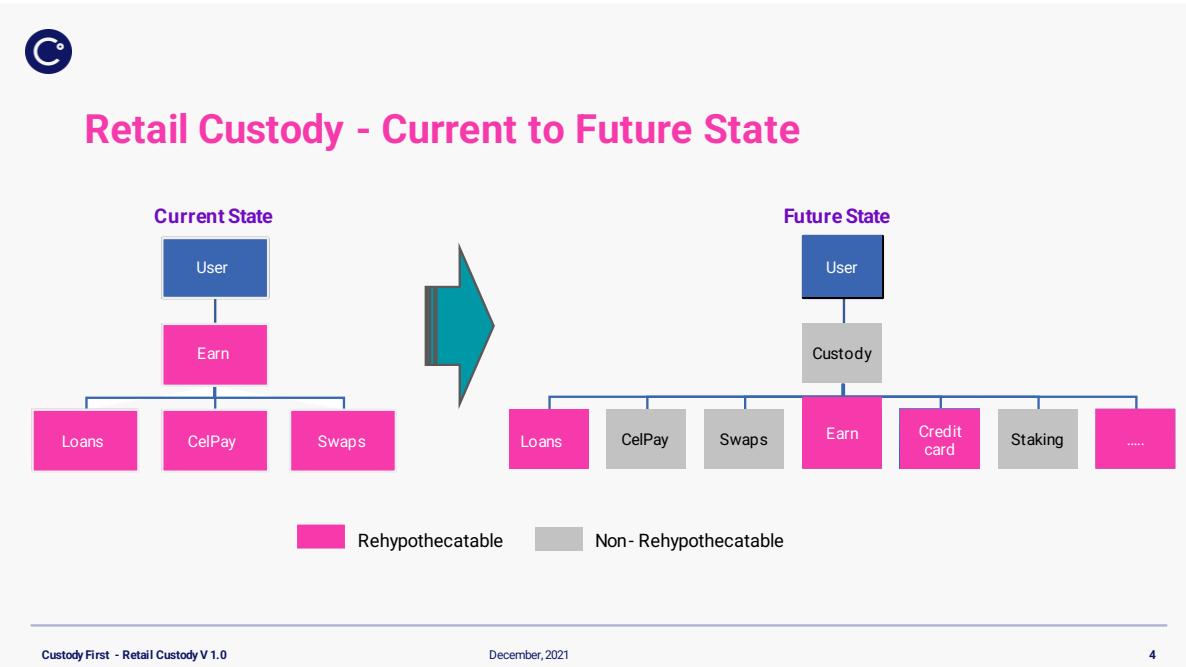
<sup>98</sup> Celsius, Custody First PowerPoint (December 2021).

<sup>99</sup> Celsius, Custody First PowerPoint (December 2021).

<sup>100</sup> *Id.*

<sup>101</sup> Celsius, Project Phoenix Retail Custody Project Overview, Version 1.

<sup>102</sup> Custody First PowerPoint Presentation (December 2021).



Under the contemplated Custody product, new customer deposits would be swept directly from the customer’s “bridge wallet” to wallets holding only assets designated for the Custody program.<sup>103</sup>

Time pressures affected the execution of Celsius’s plan. While New Jersey agreed to extend the effective date of its order multiple times, by December 2021, New Jersey regulators informed Celsius that the cease-and-desist order would become effective and require Celsius to cease offering the Earn program to unaccredited U.S. investors by February 16, 2022 (that deadline eventually moved to April 15, 2022).<sup>104</sup> New Jersey took the position that Celsius’s nationwide Earn program was offered “from” New Jersey because Celsius’s

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<sup>103</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>104</sup> New Jersey Bureau of Securities, Summary Cease and Desist Order – Second Extension (December 6, 2022), [https://www.njconsumeraffairs.gov/Actions/Celsius\\_2ndextension\\_6Dec2021.pdf#search=celsius](https://www.njconsumeraffairs.gov/Actions/Celsius_2ndextension_6Dec2021.pdf#search=celsius).

registered office was located in New Jersey, meaning that New Jersey's cease-and-desist order would have nationwide effect and require Celsius to shut down its Earn program for all unaccredited U.S. investors.<sup>105</sup> As a result, Mr. Blonstein felt Celsius had no choice but to introduce the Custody program before the New Jersey deadline, even if not fully developed.<sup>106</sup>

While Celsius began developing the Custody program months earlier, Mr. Layiwola, who led the project's development, stated that "the real work did not start until February 2022" due to the fact that Celsius was "always" short on software developers to do the necessary work to roll out new programs.<sup>107</sup> Celsius Co-Founder and former Chief Technology Officer Nuke Goldstein, who was brought in to oversee the engineering of the Custody product at the end of January 2022, noted that at that time, Celsius was still evaluating how the Custody product would work.<sup>108</sup> Celsius employees who worked on Custody universally cited time constraints as the reason why the Custody program launched in April 2022 differed in fundamental ways from previously-contemplated implementation. Mr. Noy explained that Custody's "technical limitations" were "due to time constraints" created by the impending New Jersey cease and desist order.<sup>109</sup> According to Mr. Layiwola, Celsius had a

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<sup>105</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>106</sup> Examiner Interview (Former Employee, November 3, 2022); *see also* Blonstein, Oren, Email Meeting Invitation re: Shut down of US operations if custody solution not live by 31-Mar (January 1, 2022), CEL\_EXAM-00000573.

<sup>107</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>108</sup> Examiner Interview of Nuke Goldstein (Co-Founder, Former Chief Technology Officer – Celsius, November 17, 2022).

<sup>109</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

Hobson's choice: It could either launch the Custody product it had developed as of the April 15, 2022 deadline ("real work" on which did not commence until February 2022); or it could stop accepting crypto assets in any form from non-accredited U.S. investors.<sup>110</sup> Mr. Pavon concurred, explaining that Celsius's options were "[e]ither you shut down and tell clients, 'we're running innovations, come back in a month,' or you do the best you can, which is my understanding of what they've done in retrospect."<sup>111</sup>

Celsius's contemporaneous internal communications corroborate these statements. On January 27, 2022, former Engineering Director Steven Koprivica, informed members of the Custody working group of a meeting he attended with Celsius management, including Nuke Goldstein, regarding the status of Custody's development.<sup>112</sup> Mr. Koprivica summarized management's message to the product development team as: "[G]o back to blackboard, do the minimum of all minimums, this may be manual for the start, involve less developers, lets discuss deadlines."<sup>113</sup> Mr. Goldstein recalled that meeting, when he authorized a manual reconciliation to match assets (actual wallet funds) and liabilities (customer account balances) in the Custody program in lieu of an automated system; because of this manual process, he noted that an excess "buffer" was

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<sup>110</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>111</sup> Examiner Interview of Roni Cohen-Pavon (Chief Revenue Officer – Celsius, November 15, 2022).

<sup>112</sup> See Koprivica, Steven, Custody Slack Channel (January 27, 2022), CEL\_EXAM-00000106.

<sup>113</sup> *Id.*

conceived to give Celsius a “margin for error.”<sup>114</sup> Based on this direction, Mr. Koprivica concluded that the preexisting development plan for the Custody program was “no longer valid.”<sup>115</sup>

The time pressure manifested in a product different from that originally conceived. Earlier in the project’s development, Celsius planned “a full Custody” and fully automated product through GK8 (which Celsius acquired in November 2021 to ultimately provide custodial services for all of Celsius’s crypto asset holdings) that would integrate the Fireblocks system.<sup>116</sup> In the end, however, and as explained in more detail below, the program was heavily manual and dependent on Celsius employees, not only to track assets in the Custody wallets, but also to move deposited crypto assets into those wallets. Similarly, Celsius’s original plan was that Custody customers would be able to deposit directly into the Custody wallets.<sup>117</sup> Instead, as also discussed below, when the Custody program launched on April 15, 2022, Celsius swept assets designated for the Custody program from the customer’s “bridge” wallet into Celsius’s Main wallets (*i.e.*, the same wallets into which deposits were made in the Earn program). Mr. Blonstein recalled that changing the flow of coins to go first into Custody rather

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<sup>114</sup> Examiner Interview of Nuke Goldstein (Co-Founder and Former Chief Technology Officer – Celsius, November 17, 2022).

<sup>115</sup> *Id.*

<sup>116</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>117</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

than Main wallets created “a lot of concern regarding the complexity and time to implement the program.”<sup>118</sup>

From Celsius’s perspective, while the Custody product may not have been ideal,<sup>119</sup> Celsius’s managers believed it would satisfy their immediate goals of: (i) addressing the regulators’ concerns by at least initially holding non-accredited investors’ assets in an aggregated pool of assets that would be segregated in the Fireblocks workspace, would not be subject to deployment, and could be returned to customers upon request; and (ii) keeping the non-accredited investor customers on the Celsius platform where they would be able to access Celsius’s other revenue-generating products, such as Borrow and Swap, while Celsius worked on a long-term solution.<sup>120</sup>

As the Custody launch date grew closer, however, Celsius employees discussed internally whether the Custody program was truly custodial. As Mr. Layiwola explained, during the program’s development, it was determined that Celsius could not, in the time allotted, devote the resources necessary to create a “pure custody” product,<sup>121</sup> meaning that Celsius would still store the assets in commingled Celsius wallets, without segregating each customer’s crypto assets

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<sup>118</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer – Celsius, November 4, 2022).

<sup>119</sup> As one former employee involved in the launch said, the Custody program was successful from a product perspective because it “went live and nothing went wrong.” Examiner Interview (Former Employee – Celsius, November 3, 2022).

<sup>120</sup> Examiner Interview (Former Employee – Celsius, November 3, 2022).

<sup>121</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

or correlating the aggregate assets with the total customer balance.<sup>122</sup> Mr. Layiwola also stated that other titles for the program were considered (such as default wallet) at least in part because there was no “common understanding” of the concept of custody between team members with a “finance background” and those without,<sup>123</sup> but that Celsius stuck with the “Custody” title based on Celsius’s “future plans for the program.”<sup>124</sup> Celsius did not consider creating a Custody wallet for each Custody customer. In fact, Mr. Noy did not recall that idea ever being suggested.<sup>125</sup>

### **C. Celsius’s Announcement Of Its Custody Program**

Celsius did not want to announce its Custody program until its launch was imminent for two reasons: first, the regulatory deadline might change, thereby changing the timing of the launch; and second, customers might “move on.”<sup>126</sup> As a result, Celsius limited the number of its employees who were aware of Custody’s launch until shortly before the public announcement on April 11, 2022.<sup>127</sup> Relatedly, as one employee explained, there was no

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<sup>122</sup> Leon, S. Daniel, Email re \*retail\* and GK8 next steps – Jan. 4 Meeting, CEL\_EXAM-00000229-30; Examiner Interview (Former Employee, November 3, 2022).

<sup>123</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>124</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>125</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>126</sup> Examiner Interview of Katy Osadetz (Senior Manager Product Planning – Celsius, November 16, 2022). In recognition of the potential financial impact of the transition from Earn to Custody, Celsius developed new data in its internal trackers to monitor changes in new registrations/deposits. See Celsius, ExCo Dash; Examiner Interview of Juwon Layiwola (Director – Celsius, November 17, 2022).

<sup>127</sup> Examiner Interview of Katy Osadetz (Senior Manager Product Planning – Celsius, November 16, 2022); Osadetz, Katy, Slack (March 10, 2022), CEL\_EXAM-00000004 (“Tushar stressed the sensitivity of this project, even within the organization. No advanced comms prior to regulatory announcement. Everything will trickle down from that announcement and our response.”); Osadetz, Katy, Slack (March 11, 2022)

“centralized plan” for communications regarding Custody, attributed to the fact that “Custody has no value proposition” for Celsius and “offers no security benefit” for the customer.<sup>128</sup> Consequently, “[Celsius] never tried to market it as this amazing product.”<sup>129</sup> Instead, Celsius’s messaging surrounding the Custody launch focused on exposing Celsius customers to Celsius’s other, non-Earn services such as Swap, Borrow, and eventually a planned credit card.<sup>130</sup> Stated differently, “the metric was customer retention” by “marketing our company and brand as a whole.”<sup>131</sup>

Consistent with the recollection of Celsius’s employees, Celsius did not publicize its Custody program until April 11, 2022, four days before the program went live on April 15, 2022. Celsius broadcast its announcement through its blog, its Twitter account, and emails to customers. The announcement generally informed customers that: (1) all deposits into Earn made prior to April 15, 2022 would stay in Earn (barring the customer taking some other action); (2) all deposits made on or after April 15, 2022 by U.S. customers would be placed in the Custody program; (3) accredited U.S. investors could chose to move those deposits into the Earn program; and (4) non-accredited U.S. investors could not

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CEL\_EXAM-00000047 (“How much of a heads up do we plan to give the user to the changes?”...“Based on my understanding, we’re not giving notice. We’ll announce the changes upon release.”).

<sup>128</sup> Examiner Interview of Oleena Mack (Senior Lifestyle & Communications Marketing Manager – Celsius, October 28, 2022).

<sup>129</sup> Examiner Interview of Oleena Mack (Senior Lifestyle & Communications Marketing Manager – Celsius, October 28, 2022).

<sup>130</sup> Examiner Interview of Oleena Mack (Senior Lifestyle & Communications Marketing Manager – Celsius, October 28, 2022).

<sup>131</sup> Examiner Interview of Oleena Mack (Senior Lifestyle & Communications Marketing Manager – Celsius, October 28, 2022).

move those deposits into the Earn program but could still utilize Celsius’s Borrow and Swap offerings. According to one employee in Celsius’s marketing department, other than these initial rollout communications, no additional general communications with customers regarding the Custody program were sent to customers.<sup>132</sup>

**D. Introduction Of “Withhold Accounts” To Users In Nine Non-Custody States**

When Celsius launched the Custody program, it could not lawfully offer the new product in nine states<sup>133</sup> without proper licensing (the “Non-Custody States”).<sup>134</sup> As Mr. Noy recalled, one of the “underlying assumptions” of Project Phoenix was that Celsius would be able to engage other custodians with appropriate licenses in the Non-Custody States.<sup>135</sup> But by March 10, 2022, and despite ongoing conversations, Celsius determined it was “unlikely” to establish such a partnership in time for Custody’s anticipated launch—at that point, on March 31, 2022.<sup>136</sup>

According to Celsius employees, the open nature of the blockchain made it “impossible” for Celsius to refuse incoming asset transfers, even from customers residing in a Non-Custody State; thus, they asserted, Celsius could

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<sup>132</sup> Examiner Interview of Oleena Mack (Senior Lifestyle & Communications Marketing Manager – Celsius, October 28, 2022).

<sup>133</sup> The nine states were: Connecticut, Louisiana, Nebraska, Nevada, New York, North Carolina, Ohio, Vermont, Washington.

<sup>134</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>135</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>136</sup> Celsius, Custody GTM Slack Channel (Mar. 10, 2022) CEL\_EXAM-00000004; Examiner Interview of Katy Osadetz (Senior Manager Product Planning – Celsius, November 16, 2022).

not block a registered user from sending crypto assets to their user-specific Celsius bridge wallet.<sup>137</sup> Celsius could, however, stop facilitating registered customer deposits by removing a customer's in-app access to view their deposit address. And while it did briefly block that screen display, it then reenabled the display so that users could continue to obtain the deposit address through the app. Mr. Blonstein explained that "we reenabled to allow users to see the deposit address so users could add collateral for loans" but that, as a result, the screen was reenabled for all users and not just those with loans.<sup>138</sup>

Celsius employees also explained that they could not return these assets without user/customer involvement.<sup>139</sup> While Celsius could identify the transmitting wallet address, it would not know whether the relevant user still held the private keys to that address or had exclusive or secure access to the private key.<sup>140</sup>

To address this possibility (that customers would transfer crypto assets to their now-defunct accounts), Celsius used a designation it called "Withhold" or "Withheld" accounts (the "Withhold accounts").<sup>141</sup> Celsius previously used this designation to describe certain crypto assets transferred to the platform that it could not lawfully accept, such as BNB.<sup>142</sup> Celsius considered referring to these

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<sup>137</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>138</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer – Celsius, November 4, 2022).

<sup>139</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>140</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>141</sup> Celsius, U.S. Custody Solution Launch FAQ at 5 (as of April 15, 2022).

<sup>142</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022); Blonstein Decl. at ¶6 ("[I]f customers . . . transferred BNB coins . . . to the Celsius platform, those transfers would be reflected in the customers' Withhold

as “Error” accounts but ultimately decided to call them Withhold accounts.<sup>143</sup> The mechanics of Withhold accounts and the customer confusion surrounding their operation are described *infra* Section VI.

The total value of Withhold accounts on April 15, 2022 was \$1,526,390, broken out into separate crypto asset categories as follows:<sup>144</sup>

	Withhold Account Balances as of April 15, 2022					
	CEL	BTC Equivalents	ETH Equivalent	USD/Stable Coins	Other Coins	Total
Crypto Asset Quantity	335.05	9.48	175.29	239,899.92	262,976.67	503,396.41
Crypto Asset Value (\$USD 000s)	\$ 0.77	\$ 384.59	\$ 533.04	\$ 239.52	\$ 368.48	\$ 1,526.39

As of the Petition Date, the total value of the Withhold accounts was \$13,787,420.<sup>145</sup> According to Celsius, as of August 29, 2022, approximately 5,000 users hold Withhold account assets worth approximately \$15.33 million.<sup>146</sup>

#### **E. The Terms Of Use For Custody Accounts**

Beginning April 15, 2022, when customers (new or existing) logging onto the Celsius app were presented with the following screen informing them that Celsius had “updated our Terms of Use” and requiring them to acknowledge their agreement before being allowed to continue.

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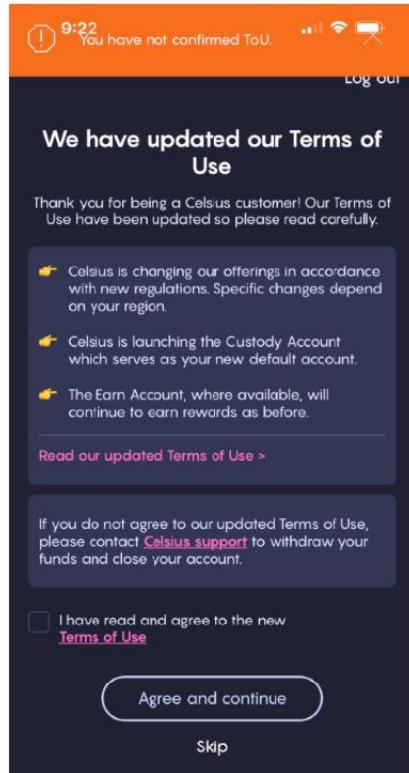
Accounts because that coin was not eligible for the Earn Program for any customer in the United States.”).

<sup>143</sup> Examiner Interview of Katy Osadetz (Senior Manager Product Planning – Celsius, November 16, 2022).

<sup>144</sup> See Appendix A, Schedules 5.3 and 5.4.

<sup>145</sup> *Id.*

<sup>146</sup> See Debtors’ Motion Seeking Entry of an Order (I) Authorizing the Debtors to Reopen Withdrawals for Certain Customers with Respect to Certain Assets Held in the Custody Program and Withhold Accounts and (II) Granting Related Relief, Dkt. 670 at ¶20.



If the customer chose to “skip” this page, the customer’s access was limited to viewing their accounts; they could not engage in transactions on the Celsius platform.<sup>147</sup> While Celsius provided a link to the updated Terms of Use, a customer did not need to access or read the Terms of Use to agree to its terms and access the Celsius platform.<sup>148</sup> Further, as shown in the screenshot above, the terms highlighted by Celsius in the app interface provided little detail about the nature of these changes.

The updated Terms of Use (dated April 14, 2022) contained several provisions addressing how Celsius would receive assets from U.S. customers

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<sup>147</sup> Examiner Interview of Katy Osadetz (Senior Manager of Product Planning – Celsius, November 16, 2022).

<sup>148</sup> Examiner Interview of Katy Osadetz (Senior Manager Product Planning – Celsius, November 16, 2022).

after the launch of the Custody program. For example, the Terms of Use stated that: “[I]f you reside in the United States and have access to Celsius’s custody service via your Celsius account, any Eligible Digital Assets transferred to your Celsius account on or after the modification date [April 15, 2022] will be initially transferred to a Custody Wallet as part of the custody service.”<sup>149</sup> The Terms of Use also stated that for an “accredited U.S. user” who has “access to the custody service,” any “Eligible Digital Asset transferred to Celsius on or after [April 15, 2022] will initially be transferred to a Custody Wallet, but may thereafter by [sic] used in the Earn Service at your discretion.”<sup>150</sup>

The Terms of Use also addressed the concept of a “Custody Wallet,” defined as a “Virtual Wallet where all Eligible Digital Assets held therein are custodial assets maintained either by us or a third party.” The Terms of Use further provided that Celsius’s “custody (‘Custody’) Service allowed customers to store Eligible Digital Assets in a Custody Wallet accessible through your Celsius Account,” and that “[b]y using the Custody Service, you understand and agree to appoint Celsius or a Third Party Custodian selected by Celsius as your agent to store and secure Eligible Digital Assets in a Custody Wallet, and perform other duties customarily performed by a custodian.”<sup>151</sup>

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<sup>149</sup> Mashinsky Terms of Use Decl. at Ex. A-8, Celsius Networks, Terms of Use (April 14, 2022). As explained in Section V.I., customer deposits into the Custody program were not initially transferred to a Custody Wallet but into Celsius’s “Main” Treasury wallet that also held deposits into the Earn program as well as other Celsius assets.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

Unlike all prior Terms of Use, the new Terms of Use stated that “title to any of your Eligible Digital Assets in a Custody Wallet shall at all times remain with you and not transfer to Celsius.”<sup>152</sup> This was a significant change from Celsius’s previous Terms of Use, which stated that “[u]nder no circumstances does Celsius hold digital assets in custody on your behalf.”<sup>153</sup> The new Terms of Use further stated: “Celsius will not transfer, sell, loan or otherwise rehypothecate Eligible Digital Assets held in a Custody Wallet unless specifically instructed by you, except as required by valid court order, competent regulatory agency, government agency or applicable law.”<sup>154</sup> At the same time, the Terms of Use noted that “Eligible Digital Assets in a Custody Wallet may be comingled with the Eligible Digital Assets of other Users, and Celsius is under no obligation to return the actual Eligible Digital Assets initially transferred by you to a Custody Wallet, but will return Eligible Digital Assets of the identical type reflected in your Celsius Account at the time you request such a return.”<sup>155</sup>

The new Terms of Use also told customers that “[a]s title owner of assets, you bear all risk of loss,” and that “Celsius shall have no liability for any Digital Asset price fluctuations.” While the Terms of Use stated that Celsius (or a third party selected by Celsius) was acting as “agent” for the customer “to store and secure” the customers cryptocurrency assets and would “perform other duties customarily performed by a custodian,” the Terms of Use also disclaimed any

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<sup>152</sup> *Id.*

<sup>153</sup> Mashinsky Terms of Use Decl. at Ex. A-7, Terms of Use (August 3, 2021).

<sup>154</sup> Mashinsky Terms of Use Decl. at Ex. A-8, Terms of Use (April 14, 2022).

<sup>155</sup> *Id.*

liability on Celsius's part, stating Celsius "shall have no liability for ... any or all loss of Digital Assets."<sup>156</sup> Moreover, Celsius reserved the right to "suspend access to ... the Custody Services and your access to a Custody wallet, in the event of market disruptions or periods of volatility."<sup>157</sup>

The new Terms of Use also explained, for the first time, that there was uncertainty in the law regarding how crypto assets, including those in a Custody wallet, would be treated in the case of an insolvency proceeding:

You understand and acknowledge that the legal treatment of Digital Assets remains unsettled and may vary depending on the jurisdiction in which you reside. In the event that you, Celsius or any Third Party Custodian becomes subject to an insolvency proceeding, it is unclear how your Digital Assets would be treated and what rights you would have to such Digital Assets. Celsius does not make any representation as to the likely treatment of Digital Assets in your Celsius Account, including those in a Custody Wallet, in the event that you, Celsius or any Third Party Custodian becomes subject to an insolvency proceeding whether in the U.S. or in any other jurisdiction. You explicitly understand and acknowledge that the treatment of Digital Assets in the event of such an insolvency proceeding is unsettled, not guaranteed, and may result in a number of outcomes that are impossible to predict reliably, including but not limited to you being treated as an unsecured creditor and/or the total loss of any and all Digital Assets reflected in your Celsius Account, including those in a Custody Wallet.<sup>158</sup>

In sum, in accordance with the updated Terms of Use, beginning on April 15, 2022, every new deposit of cryptocurrency from a U.S. customer was initially marked for "Custody." Accredited U.S. investors could, at their choosing, move those assets out of the Custody platform and into the Earn platform. Non-

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<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

accredited U.S. customers could not move their assets into Earn but could engage in swaps or loans. Moreover, when a customer sought to withdraw their crypto assets Celsius flagged that withdrawal as coming out of Custody.

Consequently, beginning April 15, 2022, any assets withdrawn from the Earn program were flagged as being moved from Earn to Custody and then transferred from Celsius to the customer. As at least one Celsius employee described it, the Custody program served as a central waystation or “lobby.”<sup>159</sup>

#### **F. Celsius Relabeled Existing Unused Wallets As Custody Wallets**

In addition to determining how the Custody program would function, Celsius also had to develop infrastructure (*i.e.*, the wallets) to hold assets designated for the Custody program. Celsius did not use individual wallets for each customer to hold that particular customer’s Custody assets. Instead, Celsius created a new Custody workspace in Fireblocks, separate from the Fireblocks workspace used for Celsius’s general deployment activities.<sup>160</sup> Within that new workspace, Celsius assigned a set of pre-existing but previously unused wallets for each crypto asset type supported by Celsius. Celsius used these wallets to hold on an aggregate basis the total amount of crypto assets that Celsius’s books and records listed as part of the Custody program.<sup>161</sup> Only a

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<sup>159</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer and Head of Innovation – Celsius, November 4, 2022).

<sup>160</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>161</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer and Head of Innovation – Celsius, November 4, 2022); Declaration Of Oren Blonstein, Head Of Innovation And Chief Compliance Officer Of Celsius Network Limited, With Respect To Certain Phase I Issues Pursuant To The Joint Stipulation And Agreed Scheduling Order By And Among The Debtors, The Committee, And The Ad Hoc Groups With Respect To

limited set of individuals at Celsius could access these omnibus “Custody” wallets, whereas many more employees had access to the main, or Treasury, wallets, which were stored in a separate workspace.<sup>162</sup>

#### **G. Celsius’s Initial Funding Of The Custody Wallets**

On the morning of April 15, 2022, Celsius began transferring assets from its “Main” wallets into designated Custody wallets. That process was substantially complete by early afternoon.<sup>163</sup> Based on an analysis of Celsius’s blockchain transactions on April 15, 2022, Celsius first funded its custodial wallets with the following number of coins:

<b>Coin Type</b>	<b>Initial Funding Amount (In Coins)</b>
CEL	82,578
BTC and equivalents	657
ETH and equivalents	1,569
USD Stablecoin	17,281,942
Other <sup>164</sup>	4,445,527

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The Custody And Withhold Issues dated October 25, 2022 [Dkt 1192] at ¶ 13; see Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022); see also Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022); see also Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022).

<sup>162</sup> Examiner Interview of Former Employee (Former Employee – Celsius, November 3, 2022).

<sup>163</sup> Layiwola, Juwon, Slack (April 15, 2022) CEL\_EXAM-00000066; see Appendix 1, Schedule 6.1.

<sup>164</sup> A full breakdown of daily blockchain funding by specific coin type is attached to this Interim Report as Appendix A, Schedule 1.

The crypto assets that Celsius initially transferred into the Custody wallets came from the following Celsius wallets:

Digital Asset	Symbol	Initial Funding Amount (Digital Assets) <sup>A</sup>	Funding Source <sup>B</sup>	Blockchain
<b>Cel Token</b>	CEL	82,578	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
		82,578		
<b>BTC</b>				
Bitcoin	BTC	648	Celsius Network LLC (US) Treasury Main Wallet	BTC
Wrapped Bitcoin	wBTC	9	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
		657		
<b>ETH<sup>2</sup></b>	ETH	1,569	Celsius Networks LLC (US) – Fireblocks – Network Deposits	Ethereum
		1,569		
<b>USD/Stablecoin</b>				
USD Coin	USDC	15,905,978	Celsius Networks LLC (US) – Fireblocks – Network Deposits	Ethereum
Gemini dollar	GUSD	1,132,958	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
TrueUSD	TUSD	221,998	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Tether	USDT	21,006	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
USD Coin	USDC	1	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Z.com USD	ZUSD	1	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
		17,281,942		
<b>Other</b>				
Songbird	SGB	1,370,771	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Cardano	ADA	838,459	Celsius Network LLC (US) Treasury Main Wallet	Cardano
Matic Token	MATIC	594,111	Celsius Networks LLC (US) – Fireblocks – Network Deposits	Ethereum
Dogecoin	DOGE	575,934	Celsius Network LLC (US) Treasury Main Wallet	Dogechain
Ox	ZRX	206,814	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Basic Attention Token	BAT	198,460	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Terra Classic	LUNC	150,000	Celsius Network LLC (US) Treasury Main Wallet	Terra
XLP	XRP	82,772	Celsius Network LLC (US) Treasury Main Wallet	Ripple
Decentraland MANA	MANA	71,270	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Synthetix Network	SNX	61,388	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
ChainLink Token	LINK	60,856	Celsius Networks LLC (US) – Fireblocks – Network Deposits	Ethereum
SushiToken	SUSHI	50,517	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
TrueHKD	THKD	41,275	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
IInch Token	IINCH	24,919	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Solana	SOL	24,859	Celsius Network LLC (US) Treasury Main Wallet	Solana
Uniswap	UNI	18,869	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Tezox	XTZ	17,222	Celsius Network LLC (US) Treasury Main Wallet	Tezos
TrueGBP	TGBP	16,295	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Bancor Network Token	BNT	15,307	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
OMGToken	OMG	6,892	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
TrueCAD	TCAD	3,061	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Dotcoin	DOT	2,644	Celsius Network LLC (US) Treasury Main Wallet	Polkadot
UMA Voting Token v1	UMA	1,923	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Dash	DASH	1,803	Celsius Network LLC (US) Treasury Main Wallet	Dash
TrueAUD	TAUD	1,797	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Paxos Gold	PAXG	1,496	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Aave Token	AAVE	1,403	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Bitcoin Cash	BCH	1,078	Celsius Network LLC (US) Treasury Main Wallet	Bitcoin Cash
Livepeer Token	LPT	834	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Litecoin	LTC	624	Celsius Network LLC (US) Treasury Main Wallet	Litecoin
Compound	COMP	612	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
eCash	ZEC	479	Celsius Network LLC (US) Treasury Main Wallet	Zcash
Avalanche	AVAX	372	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
Bitcoin SV	BSV	241	Celsius Network LLC (US) Treasury Main Wallet	Bitcoin Silver
Kyber Network Crystal v2	KNC	170	Celsius Network LLC (US) Treasury Main Wallet	Ethereum
		4,445,527		

Notes

- [1] All transactions noted above occurred on April 15, 2022 with the exception of the 1 USDT transaction which occurred on April 7, 2022
- [2] Includes only ETH. Customers do not hold BETH, stETH or any of the other ETH equivalents in Earn, Custody or Withheld accounts.

Sources:

- [A] Initial transfer amount based on review of applicable blockchain activity.
- [B] Cryptocurrency funding wallet name/description per Celsius Internal Wallet List as of October 2022.

Celsius's decision to fund the Custody wallets from its Main wallets, instead of directly transferring Custody deposits into the Custody wallets, posed several challenges. The first was how to initially fund the various Custody wallets on April 15, 2022, when Celsius would not know the number of assets it needed to hold in the Custody wallets until the end of the day. In addition, Celsius determined that it wanted to maintain a 10% buffer for each Custody wallet based on the aggregate amount of assets in Custody accounts.<sup>165</sup>

Mr. Layiwola managed many aspects of Celsius's launch of Custody, including its initial funding. According to Mr. Layiwola, Celsius wanted to overfund its internal Custody accounts, as compared to the crypto assets customers held in their Custody accounts.<sup>166</sup> Celsius believed that overfunding, along with a 10% buffer, would ensure it could handle any potential negative customer reaction to, and subsequent withdrawals from, Custody.<sup>167</sup> The logic was that, over time, Celsius would study customer behavior and eventually be able to bring the buffer close to zero, in which case Celsius's Custody accounts on Fireblocks would match the assets in customer accounts.<sup>168</sup>

Because of the manner in which Celsius initially funded the Custody wallets—most notably the intentional overfunding—on April 15, 2022, no Custody wallet held exactly the number of coins that were supposed to be a part of the Custody program.

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<sup>165</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, November 17, 2022).

<sup>166</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, November 17, 2022).

<sup>167</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, November 17, 2022).

<sup>168</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, November 17, 2022).

This initial imbalance created accounting issues for Celsius. As Chris Ferraro, Celsius's then-Head of Financial Planning & Analysis and Investor Relations and now Interim CEO, explained in an email on April 19, 2022, "custody is not on our balance sheet" and "so should not be part of net exposure we manage from deployment/risk perspective."<sup>169</sup> Dean Tappen, Celsius's Coin Deployment Specialist, responded that "currently we have sent more coins to our custody account than Users balances flagged as Custody" and that "methodology ... is making it really difficult to access our net positions."<sup>170</sup>

#### **H. How The Custody Accounts Worked In Practice; What The Customer Saw When Moving Crypto Assets Into And Out Of A Custody Account**

As referenced above, Celsius updated its Terms of Use and created customer communications to alert its customers about how deposits into the new Custody accounts would be treated. On April 11, 2022, a Celsius blog post advised that "[n]ew transfers made by non-accredited investors in the United States will be held in their new Custody accounts."<sup>171</sup> Celsius's updated April 14, 2022 Terms of Use stated that, beginning April 15, 2022, cryptocurrency deposits of U.S. customers for whom the Custody service was available, "will be initially transferred to a Custody wallet as part of the custody

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<sup>169</sup> Ferraro, Chris, Email re: Custody vs Earn in Freeze (April 19, 2022), CEL-UCC-00065642.

<sup>170</sup> Tappen, Dean, Email re: Custody vs Earn in Freeze (April 19, 2022), CEL-UCC-00065645.

<sup>171</sup> Important Celsius Update for our Users in the United States, Medium (April 11, 2022), <https://celsiusnetwork.medium.com/important-celsius-update-to-our-us-clients-6df471420cc7>.

service.”<sup>172</sup> By 12:43 PM on April 15, 2022, 8,382 users signed the new Terms of Use.<sup>173</sup> A Frequently Asked Questions (“FAQ”) document prepared for Celsius’s Customer Care team explained that, for non-accredited investors, “[a]ll new coin/token transfers into Celsius will go to the Custody account,” and that, in the app, “total balances of Earn and Custody accounts will be visible from the Portfolio account” while “[s]wiping to Earn (if applicable) and Custody accounts will allow you to see detailed breakdowns.”<sup>174</sup>

From the customer’s perspective, that is, in fact, what appeared to occur: When the customer deposited crypto assets to a Celsius Custody account, the Celsius app reflected those deposits immediately. Mr. Layiwola, who helped lead the Custody program, noted that “when a user deposited coins into their custody account, they showed up in a custody account on the user’s app.”<sup>175</sup> Mr. Tappen noted the same, stating that users saw instantaneous movement of assets in custody on the app.<sup>176</sup>

Additionally, Celsius employees who reviewed the app’s functionality when Custody launched confirmed that users would see the change in the account balance. Mitch Eger, Celsius’s former Senior Product Marketing Manager, noted that he “made a swap[,] no problem” and the “[t]ransfer between earn and

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<sup>172</sup> Celsius Networks, Terms of Use (April 14, 2022).

<sup>173</sup> Bujosevic, Vladimir, Slack (April 15, 2022), CEL\_EXAM-00000063 (Celsius Network).

<sup>174</sup> Celsius, US Custody Solution Launch FAQ (as of April 15, 2022).

<sup>175</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>176</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

custody works well.”<sup>177</sup> Katy Osadetz, another Celsius employee, opened the app to see what her balance showed. When she did not see a balance in her Custody account, Mr. Eger informed her that the balance would show if crypto assets were transferred to Custody.<sup>178</sup>

Once a customer had crypto assets in their Custody account, they could transfer those crypto assets to other Celsius products (e.g., staking or swaps) or withdraw them entirely to their desired non-Celsius wallet. From the user perspective, those transfers come from their Custody account; and in fact, Celsius required all withdrawals by a customer be made through Custody, even for crypto assets originating in Earn.<sup>179</sup>

### **I. What The Company Did With User Crypto Assets Transferred Into Custody Accounts**

Celsius’s actual movement of coins within its network differed from what its customers could see.<sup>180</sup> From a blockchain perspective, a customer’s crypto assets were, in fact, not initially transferred to a Custody wallet at Celsius. Instead, as an initial step, the customer’s assets were transferred to a user- and asset-specific bridge wallet.<sup>181</sup> As noted above, Celsius had created similar

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<sup>177</sup> Eger, Mitch, Slack (April 15, 2022), CEL\_EXAM-00000027.

<sup>178</sup> *Id.*

<sup>179</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>180</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022) (“What the user saw was different than what the company was doing with the coins initially.”); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022) (noting that the liability was merely flagged and did not necessarily equate to the movement of coins). Mr. Blonstein’s Declaration further acknowledged that “a customer request to transfer a particular digital asset balance to [] that customer’s Custody account did not immediately nor necessarily result in a movement of coins on the blockchain.” Blonstein Decl., ¶ 11.

<sup>181</sup> Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022).

wallets for users in its Earn program prior to April 15, 2022. Each individual user had their own set of wallets specific to them and into which specific crypto assets could be deposited.<sup>182</sup> For example, Individual A’s BTC deposits would go to a different wallet than Individual A’s ETH deposits. A user’s deposit addresses were stored and visible to them through the app.<sup>183</sup>

As explained above, Celsius opened bridge wallets for customers so that it could identify and record the transactions of specific users.<sup>184</sup> Celsius then periodically “swept” the bridge wallets, collecting assets transferred there through an automated process and then transferring them into Celsius’s aggregated (or Main) wallet for that currency.<sup>185</sup> Celsius conducted these sweeps “as soon as [it] [could],” but Mr. Tappen acknowledged that there was sometimes a delay.<sup>186</sup>

Following the Custody program’s launch, as had been the case pre-Custody, the majority of crypto assets<sup>187</sup> were first swept into Main wallets

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<sup>182</sup> Blonstein Decl., ¶16.

<sup>183</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>184</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022). As Mr. Tappen put it, “the reason for separate wallets is for the identifier. The only reasons we know you are sending coins is because you have a wallet.” *Id.*

<sup>185</sup> Blonstein Decl., ¶ 17.

<sup>186</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>187</sup> There are circumstances where the amount in a customer’s bridge wallet is of a de minimis value that Celsius does not sweep the customer’s wallet as the expense Celsius would incur to do so exceeds the amount of cryptocurrency that would be procured. Examiner Interview of Dean Tappen, Coin Deployment Specialist – Celsius, October 13, 2022. The threshold for the sweeps was calculated automatically; the residual amounts are referred to as “dust.” Examiner Interview of Nuke Goldstein (Co-Founder and Former Chief Technology Officer – Celsius, November 17, 2022).

regardless of whether the customer had marked a transaction for their Earn or Custody accounts. That is, assets in the bridge wallets were swept into the Main wallets for that particular asset, where all assets were commingled with other customer deposits.<sup>188</sup> Mr. Tappen noted that assets in the Main wallets were “pooled and aggregated” to the point that Celsius lost the ability to track the assets back to the customer who deposited them.<sup>189</sup> Accordingly, once Celsius swept deposits from the bridge wallets, Celsius could not attribute a specific crypto asset to a specific customer.<sup>190</sup>

Celsius did not automatically move crypto assets it had swept into the Main wallet from “Custody” customer bridge wallets to a Custody wallet. Nor did Celsius move coins into a Custody wallet for each deposit that a Custody customer made. Instead, on a periodic basis, Celsius performed a manual reconciliation (described in detail below *infra* Section V.I.) between what customers had deposited into (or withdrawn from) their Custody accounts and the amount of each respective crypto asset actually held in Celsius’s Custody wallets in Fireblocks.<sup>191</sup> Based on that aggregate reconciliation, Celsius would either add (if the net Custody balances had increased) or remove (if the net

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<sup>188</sup> Blonstein Decl., ¶ 17.

<sup>189</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>190</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>191</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022); Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022).

Custody balances had decreased) coins from the Custody wallets.<sup>192</sup> A schedule of transactions on a coin by coin basis to and from the Celsius Custody wallets based on Blockchain analysis is included as Schedule 1 to Appendix A, beginning with an initial deposit of 1 USDC (stablecoin) on April 7, 2022, and concluding on the Petition Date.<sup>193</sup> Data in Schedule 1 includes the initial funding of the Custody wallets and subsequent coin movements to and from those wallets taking place prior to and during the Pause.

There was no automated process to carry out any reconciliation—all transfers were done manually by Celsius personnel.<sup>194</sup> At no point in time were a customer's crypto assets moved into a Custody wallet created for that individual customer because no such individual Custody wallets exist.<sup>195</sup>

The following is a diagram of customer deposits into Custody, with C2 representing the aggregate, periodic reconciliation process:<sup>196</sup>

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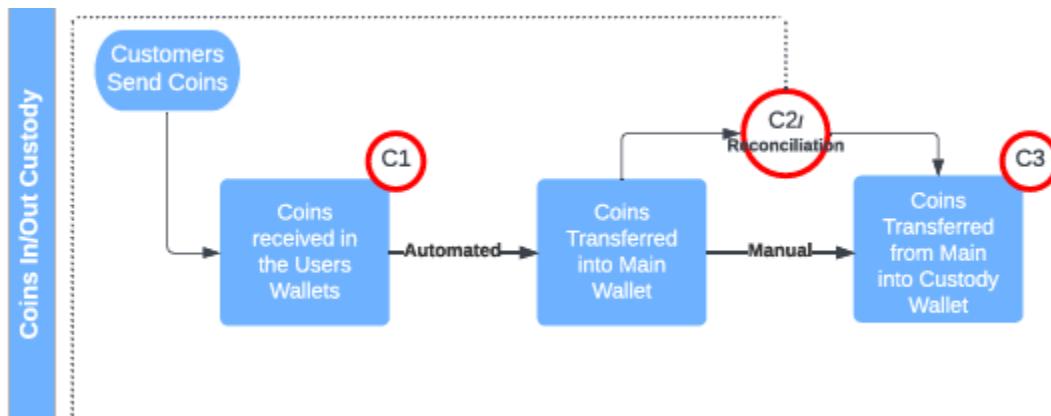
<sup>192</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022); Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022).

<sup>193</sup> Appendix A, Schedule 1.

<sup>194</sup> See Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022).

<sup>195</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022). Mr. Blonstein's Declaration also notes that “a request to move digital assets from the Custody Service was satisfied []in the aggregate[].” Blonstein Decl., ¶ 19.

<sup>196</sup> *Excerpt from Celsius Coin Movements: Custody (Coin Movements: Custody v2 – Custody Process).* This graphic was developed by Adrian Alisie, Global Head of Business Processes/Controls Optimization, in July 2022, after the Company had declared bankruptcy, in order to depict a pre-bankruptcy process. Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022); Examiner Interview of Adrian Alisie (Global Head of Business Processes/Controls Optimization – Celsius, October 31, 2022). Mr. Alisie based this graphic on the descriptions provided by others, but disclaimed any independent knowledge of the coin movement process. Examiner Interview of Adrian Alisie (Global Head of Controls/Business Optimization – Celsius, October 31, 2022).



The user perspective for withdrawals also did not mirror the underlying coin movement. When users made withdrawals from Custody accounts, Celsius did not actually transfer coins from the Custody wallets. Instead, Celsius used crypto assets in the frictional wallets located outside of the Custody workspace in Fireblocks to fund withdrawals.<sup>197</sup> Mr. Tappen described the frictional wallets as the “company’s ATM,”<sup>198</sup> and these frictional wallets were funded from the Main wallets through a “topping off” process run by Treasury.<sup>199</sup> Celsius based the amount of crypto assets kept in the frictional wallets on the 95<sup>th</sup> percentile of historical withdrawal levels.<sup>200</sup> A user would request a withdrawal, the withdrawal would come from the frictional wallets, and the withdrawal would be cleared if the assets were in a frictional wallet and no other processes were flagged (such as a blacklisted wallet or a withdrawal request large enough to

<sup>197</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 18, 2022); Blonstein Decl., ¶¶ 19 n.9, 20.

<sup>198</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 18, 2022).

<sup>199</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 18, 2022).

<sup>200</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

trigger a manual review).<sup>201</sup> As a result of these processes, a customer would not receive the particular crypto asset that she had initially deposited, or any asset sourced from the Custody wallets, “but, rather, an equivalent amount of such crypto in-kind.”<sup>202</sup>

**J. How Celsius Determined And Accounted For Coin Movement In And Out Of Custody**

Celsius intended for the reconciliation process to proceed as follows.<sup>203</sup> First, Celsius ran a daily report of the net amount of each coin that customers intended to hold in their Custody accounts through that date.<sup>204</sup> Second, Celsius added a “buffer” to this total customer balance, a cushion intended to ensure that the Custody wallets did not suffer a shortfall of coins at any given time.<sup>205</sup> The buffer also minimized the frequency with which it was necessary for Celsius to move coins in and out of Custody wallets. Celsius contemplated a 10%

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<sup>201</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer and Head of Innovation – Celsius, November 4, 2022); Examiner Interview of Nuke Goldstein (Co-Founder and Former Chief Technology Officer – Celsius, November 17, 2022).

<sup>202</sup> Blonstein Decl., ¶ 19 n.9.

<sup>203</sup> As originally contemplated, the reconciliation process was intended to be an automated process and be run out of Celsius’s “Middle Office.” However, due to the accelerated timeline of the Custody rollout, automation was not engineered and Mr. Layiwola ultimately had to manage the manual reconciliation process on top of his normal responsibilities. Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022); Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>204</sup> Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022); Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>205</sup> David Ogilvy, Slack Channel: custody gtm leads (April 15, 2022), CEL\_EXAM-00000066.

buffer,<sup>206</sup> though in practice it varied based on coin type from between 5% and 10% of the aggregate Custody account balance.<sup>207</sup>

Finally, Celsius determined the total amounts actually held in the Custody wallets for each crypto asset within the Fireblocks workspace and calculated the delta between the assets in Fireblocks and the aggregated Custody account balances plus buffer.<sup>208</sup> A relative deficit in Fireblocks indicated the amount of crypto assets that Celsius needed to move to the Custody wallets. Celsius transferred crypto assets to cover the shortfall from Main or, if there were insufficient coins in Main (particularly when there was a significant variance in illiquid assets, known internally as a “material break”), they enlisted assistance from its Treasury department. Treasury used its familiarity of the liquidity of each asset based on Celsius’s deployment strategy to determine the most efficient and cost-effective way to access coins and transfer those assets into Custody to “true up” Celsius’s account balances.<sup>209</sup> If there was a surplus in the

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<sup>206</sup> Layiwola, Juwon, Email between Arik Pupko, Ishai Inbar, and Chris Ferraro, Fwd: Freeze flow meeting today (May 9, 2022), CEL-UCC-00076095 (“[W]e [Celsius] try to keep a 10% buffer across all coins in our custody wallet.”); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

<sup>207</sup> Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022). Mr. Tappen understood that there was no “buffer” when the Custody program was first launched, and that this was something developed several days later as Celsius recognized that it had over-funded the Custody wallets relative to user deposits and therefore was under-stating its net position. Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022); Tappen, Dean, Email re custody vs earn in Freeze (Apr. 19, 2022), CEL\_UCC-000071190. By contrast, Mr. Layiwola recalled that the Custody team had developed the buffer concept prior to launch. Examiner Interview of Juwon Layiwola (Director – Celsius, November 17, 2022).

<sup>208</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>209</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022); Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022); Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

Custody wallets, Celsius typically moved excess crypto assets from Custody to Main wallets so that it could deploy those crypto assets for its investment activities.<sup>210</sup>

To cover shortfalls for certain crypto assets, Celsius noted a “need to source” the coins.<sup>211</sup> When sourcing coins, Treasury first looked to its undeployed, liquid assets, and transferred those crypto assets to Custody.<sup>212</sup> If there were insufficient undeployed assets to source the coins, Treasury evaluated which strategies to unwind, which could depend on the relative liquidity (*i.e.*, time it would take to unwind) and the annual percentage yield (*i.e.*, the opportunity cost of unwinding the strategy).<sup>213</sup> Treasury could also borrow from DeFi, but Celsius took the position that it would not purchase coins to fund Custody.<sup>214</sup> As a result, Treasury did not always source sufficient coins to cover every shortfall.<sup>215</sup>

Celsius’s implementation of the reconciliation process varied from the process as it was initially envisioned in numerous ways. Although Celsius

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<sup>210</sup> *Id.*

<sup>211</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

<sup>212</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

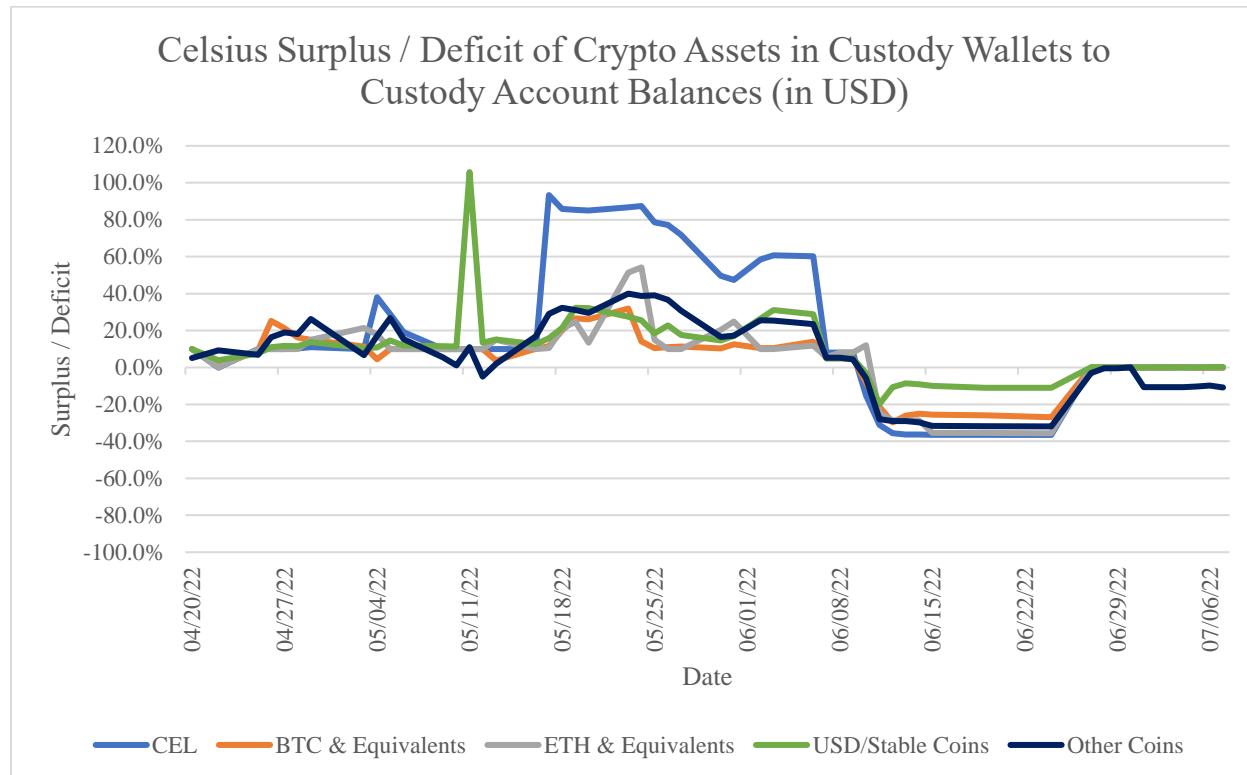
<sup>213</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

<sup>214</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

<sup>215</sup> See Appendix C (reflecting May 9, 2022 Reconciliation Report data), Celsius, custody\_balance (A&M) (Oct. 28, 2022) (“Reconciliation Report”); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

personnel received a daily Reconciliation Report,<sup>216</sup> they did not daily perform the reconciliation.<sup>217</sup>

Appendix A Schedule 2 (summarized in the chart below) provides the surplus or deficit with respect to the Custody accounts on each day the manual reconciliation took place.<sup>218</sup>



As indicated in Schedule 2, Celsius did not conduct a reconciliation for the first four days after Custody launched. In total, Celsius only completed

<sup>216</sup> The Reconciliation Report produced to the Examiner was a running spreadsheet, where each day's new data was appended to the bottom of the spreadsheet where the prior day's data concluded.

<sup>217</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 18, 2022); Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>218</sup> See Appendix A, Schedule 2.

53 reconciliations during the 83-day period between April 20, 2022, and July 12, 2022.<sup>219</sup> In addition, although Celsius ran a 24/7 business that operated on a global scale, it did not perform reconciliations over weekends. Nor did it treat the buffer as mandatory: Celsius's reconciliation data illustrated that the crypto assets transferred to the Custody wallets was often less than what would have been required for a 10% buffer.

Due to a delay in access to the Fireblocks workspaces for relevant personnel, Celsius prepared the first reconciliations on April 20, 2022, five days after it launched the Custody program and initially funded its Custody wallets.<sup>220</sup> By April 20, 2022, according to the Reconciliation Report, the Custody wallets had already fallen out of balance with customer deposits, and shortfalls were not corrected until the date of the next reconciliation. The table attached as Appendix C shows an excerpt from the May 9, 2022 Reconciliation Report, when multiple Custody wallets fell short of the Custody account balances.

Celsius did not have documented rules or policies to guide the reconciliation process, and thus no written guidance for when the reconciliations should occur or a mandated buffer value.<sup>221</sup> Although Mr. Layiwola recalled that

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<sup>219</sup> Dates for which reconciliations were prepared by Celsius: April 20, 22, 25, 26, 27, 28, 29; May 3 ,4, 5, 6, 9, 10, 11, 12, 13, 16, 17, 18 , 19, 20, 23, 24, 25, 26, 27, 30, 31; June 1, 2, 3, 6 ,7, 8, 9, 10, 11, 12, 13, 14, 15, 19, 24, 27, 28, 29, 30; July 1, 4, 5, 6, 7, 12. Reconciliation Report.

<sup>220</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, November 18, 2022).

<sup>221</sup> Celsius employees frequently noted the accelerated timeframe to launch Custody, which created technical and operational difficulties. Among others, Mr. Tappen recalled that implementing the new process was a “scramble” and “not well [thought] out ahead of time.” Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

the team may have drafted reconciliation procedures, he did not believe they were finalized,<sup>222</sup> and Celsius was unable to locate any such procedures. Adrian Alisie, who documented the flow of coins for Custody reconciliations in July 2022, was not aware of any such documentation.<sup>223</sup> Mr. Layiwola acknowledged that Celsius never “fleshed out the process fully” and had not quantified when to get Treasury involved to address a shortfall.<sup>224</sup> Employees reported that they thus relied on their “innate sense of how liquid or illiquid the coins or assets were” when they considered whether to involve Treasury.<sup>225</sup> The Chief Compliance Officer and Head of Innovation, Mr. Blonstein, did not know the basics of the manual reconciliation process; he had assumed it was automated, and agreed that the process was “not sufficiently robust.”<sup>226</sup>

#### **K. How Celsius Accounted For User Crypto Assets Transferred Into Custody Accounts**

In May 2021, Celsius began tracking its assets and liabilities in a Google Sheets workbook, referred to as the “Freeze Report.” Celsius prepared these reports initially on a weekly basis and then more frequently over time.<sup>227</sup> The

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<sup>222</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>223</sup> Examiner Interview of Adrian Alisie (Global Head of Controls/Business Optimization – Celsius, October 31, 2022).

<sup>224</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>225</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>226</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer – Celsius, November 4, 2022).

<sup>227</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 6, 2022); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022). Alvarez & Marshal explained on October 13, 2022 that the Freeze is what underlies the Coin Reports that are now being produced in connection with these Chapter 11 proceedings.

Freeze Report provided a moment-in-time “snapshot,” an approach deemed necessary because the amounts and value of Celsius’s, and its customers’, crypto assets were constantly changing.<sup>228</sup> One particular worksheet in the Freeze Report, called “Coin Stats,” provided a summary of the assets and liabilities on a per-coin basis.<sup>229</sup>

For certain inputs, like crypto assets held in wallets managed via the Fireblocks workspaces, the Freeze Report pulled data from application programming interfaces (“API”); for others, such as customer account data, Celsius pulled internally from the back-office systems, which Mr. Tappen described as a “data aggregator and internal database.”<sup>230</sup> Prior to the creation of the Freeze Reports in May 2021, Celsius did not have a method to track its assets and liabilities in a single location, but instead went “into each wallet” manually to check balances.<sup>231</sup> Celsius created the Freeze Report as part of a broader effort to “build a more organized process,” including a variety of financial reports aimed at informing “more educated” decisions.<sup>232</sup>

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<sup>228</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 6, 2022). The Freeze was not run at the same time each day and included sometimes significant errors and variations. Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022). Although concerns were raised regularly about the Freeze’s reliability, there was no off-the-shelf solution for Celsius to use. *Id.*

<sup>229</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 6, 2022); Celsius, Freeze – April 15 (April 15, 2022).

<sup>230</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 6, 2022); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

<sup>231</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>232</sup> Examiner Interview of Roni Cohen-Pavon (Chief Revenue Officer – Celsius, November 15, 2022).

There are discrepancies between certain Freeze Reports and other Celsius records for reported values of the same asset or liability on particular dates.<sup>233</sup> Mr. Tappen identified several reasons why this might occur: (1) the reporting relied on a manual process, which can cause delay in updating some values; (2) a data issue related to pending withdrawals that would remove something from a Custody wallet but then gets reversed; (3) Withhold accounts being lumped in with Custody accounts; (4) internal transfers are recorded between Earn and Custody but are not yet readily available at the time the report is generated; and (5) the time delay associated with global reconciliation.<sup>234</sup> Mr. Layiwola explained that he worked out any discrepancies verbally, came to a “common consensus,” and signed off on the Freeze Report if he determined it was accurate.<sup>235</sup> Mr. Tappen recalled material errors in the Freeze Reports and advised leadership of the issue; at the same time, however, he said there was no single product Celsius identified as an alternative.<sup>236</sup>

Following the April 15, 2022, launch of Celsius’s Custody service, Celsius began reporting Custody asset balances in the Freeze Report, drawing on the balances of Celsius’s Custody wallets. That is, the Freeze Report pulled data directly from the Fireblocks API, which showed exactly how much of each crypto

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<sup>233</sup> The Examiner reviewed Freeze Reports from the following dates: December 31, 2021; March 30, 2022; April 13, 15, 18, 29, 2022; May 6, 9, 31, 2022; June 1, 10, 13, 15, 17, 20, 24, 27, 30, 2022; July 1, 12, 13, 14, 31, 2022; August 31, 2022; September 2, 9, 16, 23, 30, 2022; and October 7, 14, 21, 28, 2022.

<sup>234</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>235</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>236</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

asset Celsius actually held in its Custody wallets.<sup>237</sup> Accordingly, this data represented the amount of crypto that Celsius actually held in Custody accounts (*i.e.*, assets), rather than the amounts reflected in individual customer Custody accounts (*i.e.*, liabilities).

Celsius did not track coins held in Custody accounts as a separate liability on the Freeze Reports until May 9, 2022, 24 days after Custody's launch. Beginning on May 9, 2022, Celsius added a new column to the Coin Stats sheet that compared the dollar value of Custody assets (as pulled from Fireblocks) to the Custody liabilities, calculated on a coin-by-coin basis. This data point—which allowed Celsius to determine whether customer Custody assets exceeded what Celsius had placed in the Custody wallets—was referred to as the “Custodian Reserve” balance.<sup>238</sup> Of note, on the first day Celsius recorded the Custody liability, it recorded a negative Custodian Reserve of \$103,300.<sup>239</sup> A summary of Custody balances, including assets, liabilities, and Custodian Reserves, according to the Freeze Report, is provided in Appendix A, Schedule 4.<sup>240</sup> A summary of Custody wallet activity according to reports

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<sup>237</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

<sup>238</sup> Huron’s review of the Freeze Reports from May 9, 2022 through June 10, 2022 revealed that, on some days, the Custodian Reserve did not match the difference between the Custody Liability and Custody Assets for certain coins, including Spark, Badger, CRV, MKR, Sushi, Taud, TCAD, TGBP, and THKD. At its highest, this difference was roughly \$31,000.

<sup>239</sup> Huron’s review of the difference between Custody assets and liabilities on May 9, 2022 indicated a difference of \$106,224, rather than \$103,300.

<sup>240</sup> See Appendix A, Schedule 4.

generated from Fireblocks is included as Appendix A, Schedule 6.<sup>241</sup> The following table summarizes the net Custody wallet activity for each category of crypto assets between April 7, 2022 (the first transfer in or out of a Custody wallet) and July 27, 2022 (the last transfer in or out of a Custody wallet):<sup>242</sup>

Custody Wallet Activity for the period April 7 - July 27, 2022 (by Celsius Category)					
(Crypto Asset Quantity)	CEL Token	BTC & Equivalents	ETH & Equivalents	USD/Stable Coins	Other Coins
Custody Wallets Utilized	1	28	1	1	128
Inflows	2,449,941.94	6,905.99	58,569.08	98,957,169.79	78,224,694.90
Outflows	539,519.51	3,370.50	16,191.86	54,944,484.20	14,644,983.14
Net Activity	1,910,422.43	3,535.49	42,377.22	44,012,685.59	63,579,711.76

The Freeze Report did not begin to report liabilities for Withhold accounts until the Petition Date. Celsius did not separately identify Withhold assets in the Freeze Reports, and assets related to “Withhold” accounts remained in the Main wallets and could be deployed by Celsius for its own use just as any other Celsius asset, and were thus reported as Celsius assets in the Freeze Report.<sup>243</sup> When asked about how “Withhold” was treated on the Freeze Report, Mr. Tappen noted that it could be inconsistent and “Withhold accounts sometimes are lumped in with Custody accounts.”<sup>244</sup>

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<sup>241</sup> See Appendix A, Schedule 6.2.

<sup>242</sup> Celsius used 155 unique cryptocurrency wallets to hold crypto assets for Custody. Certain wallets, such as the Ethereum wallet, held a variety of assets including ERC-20 tokens which are included in more than one of the categories above. For this reason, the sum of the wallets used for each of the five categories exceeds 155. See Appendix A, Schedule 6.2.

<sup>243</sup> Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022); Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022); Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

<sup>244</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

## VI. The “Withhold” Accounts

### A. Withhold Assets Were Not Treated as Custodial Assets

Celsius created the “Withhold Accounts” concept to address the accounts of unaccredited U.S.-based customers residing in the nine states in which Celsius did not have a license to maintain Custody accounts.<sup>245</sup> After April 15, 2022, Celsius treated all new transfers of crypto assets by “Withhold” customers, including crypto assets used to repay loans obtained through Celsius’s Borrow Program, were treated as deposits for customers’ Withhold accounts.<sup>246</sup> Withhold account transactions were tracked internally for accounting purposes, but from a user perspective, none of the Celsius services could be used.

Withhold account assets were not segregated from any other assets on Celsius’s platform, or in any other way treated as customer assets.<sup>247</sup> Any new Withhold account deposits were transferred from the customer’s bridge wallet to the Celsius Main wallets, just as Earn program and Custody program assets were. Those assets were then commingled and deployed in the same manner as new deposits from Earn customers or existing Celsius assets.<sup>248</sup> Mr. Blonstein

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<sup>245</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>246</sup> See *Debtors’ Motion Seeking Entry of an Order (I) Authorizing the Debtors to Reopen Withdrawals for Certain Customers with Respect to Certain Assets Held in the Custody Program and Withhold Accounts and (II) Granting Related Relief* dated September 1, 2022 [Dkt. 670] at 10.

<sup>247</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022).

<sup>248</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, October 13, 2022); Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022); Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022).

could not explain why the assets associated with Withhold accounts were not treated as custodial assets and were commingled rather than kept in customers' respective customer bridge wallets, or even a separate wallet designated for Withhold accounts.<sup>249</sup>

#### **B. Celsius's Communications to Users About Withhold Accounts**

Celsius addressed the Withhold accounts in FAQ's made available to individuals who called the Customer Care team at the start of the Custody program in April 2022. In that communication, Celsius asked its users to withdraw coins from Withhold accounts "as soon as possible" while reassuring users that "[s]uch coins [would] be held by Celsius until withdrawn by you."<sup>250</sup> Celsius did not post the Withhold FAQs on the website, despite posting Custody FAQs. Celsius has since stated that assets in Withhold Accounts "could only be withdrawn by the user or used to make payments (or respond to margin calls) if the customer had a loan with Celsius."<sup>251</sup>

Celsius did not have Terms of Use for the Withhold accounts, which apparently was because Celsius deemed them not to be a product offering.<sup>252</sup> Nor did Celsius's website provide readily-available information to explain the function of a Withhold account. Instead, Mr. Noy explained that Non-Custody State customers who deposited crypto assets in their Celsius account would

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<sup>249</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer and Head of Innovation – Celsius, November 4, 2022).

<sup>250</sup> Celsius, U.S. Custody Solution Launch FAQ at 5 (as of April 15, 2022).

<sup>251</sup> Celsius, Answers to UCC Questions about Custody and Withheld Accounts (October 10, 2022).

<sup>252</sup> According to Debtors' counsel, this is because Withhold was not a "product" offered by Celsius.

receive an email informing them that their asset was held in a Withhold account because it did not qualify for Earn or Custody treatment, would remain there until withdrawn, and would not earn rewards.<sup>253</sup> Mr. Goldstein stated that he did not know about the existence of the Withhold accounts until the Chapter 11 filings, and he was unfamiliar with any specifics about those accounts.<sup>254</sup> In other Examiner interviews, several Celsius Withhold customers reiterated that very little public information was available about the Withhold accounts.<sup>255</sup>

The restricted treatment of Withhold accounts from the user perspective diverged from Celsius's treatment of Withhold assets. That designation appears to have confused at least some of the Celsius users. Withhold customers reported they believed assets held in Withhold were kept separate from assets held in Earn or elsewhere within Celsius.<sup>256</sup>

Celsius customers seeking to withdraw tokens from their Withhold accounts could not initiate withdrawals directly from the Celsius app. Instead, to initiate the withdrawal, Celsius customers had to contact the Customer Care team, which Ms. Osadetz explained was a result of the shortened timeline to launch the Custody program.<sup>257</sup> With more time, the engineering team would have worked to develop a technical solution for app-based withdrawals.<sup>258</sup> Once

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<sup>253</sup> Examiner Interview of Yarden Noy (Head of Regulation – Celsius, November 13, 2022).

<sup>254</sup> Examiner Interview of Nuke Goldstein (Co-Founder, Former Chief Technology Officer – Celsius, November 17, 2022).

<sup>255</sup> Examiner Interview of Two Withhold Customers (November 17, 2022).

<sup>256</sup> Examiner Interview of Two Withhold Customers (November 17, 2022).

<sup>257</sup> Examiner Interview of Katy Osadetz (Senior Manager Product Planning – Celsius, November 16, 2022).

<sup>258</sup> *Id.*

the customer initiated the withdrawal, Celsius implemented that withdrawal from Withhold accounts in the same way it implemented withdrawals from its Custody or Earn programs.<sup>259</sup> Celsius transferred crypto assets from Celsius's frictional wallets to the wallet the Withhold customer designated.<sup>260</sup>

Withhold customers expressed confusion about their accounts. For example, one user explained that he "discovered that [he] had a 'Withhold Account'" only because it "appeared without explanation on the Celsius app."<sup>261</sup> According to that user, once Celsius "transferred" his assets to the user's Withhold Account, Celsius immediately "stopped awarding interest."<sup>262</sup> Customers recalled receiving a notification when seeking to transfer Earn assets to Withhold, advising them that the transfer was irreversible, *i.e.*, those funds could not be returned to the Earn account.<sup>263</sup> Users also noted that "each transfer out of the Earn Program into a Withhold Account" is associated with "a unique, 32-character transaction identifier" in spreadsheets downloaded from the Celsius system that reflect a user's transactions on the Celsius platform.<sup>264</sup> However, that identifier appears to be an internal transaction reference and does not appear to correlate to any specific blockchain transaction.

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<sup>259</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer and Head of Innovation – Celsius, November 4, 2022).

<sup>260</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer and Head of Innovation – Celsius, November 4, 2022).

<sup>261</sup> Declaration of Robert Riskin, Ad Hoc Ex A9 ¶ 6; *see also* Declaration of Alvaro Drevon, Ad Hoc Ex. A10; Declaration of Chris Lovette, Ad Hoc Ex. A11 [Dkt. 1289].

<sup>262</sup> Declaration of Robert Riskin, Ad Hoc Ex. A9 ¶ 9.

<sup>263</sup> Examiner Interview of Two Withhold Customers (November 17, 2022).

<sup>264</sup> Declaration of Larry Fulton, Ad Hoc Ex. A1 ¶ 7; Declaration of Kaveh Bastani, Ad Hoc Ex. A7.

At the time of the Pause, Celsius data reflect that Withhold customers requested withdrawals that Celsius did not execute, leaving \$2.15 million in pending withdrawals.<sup>265</sup>

## **VII. Custody and Withhold Activity Around The June 12, 2022 Pause**

### **A. Celsius's Pause**

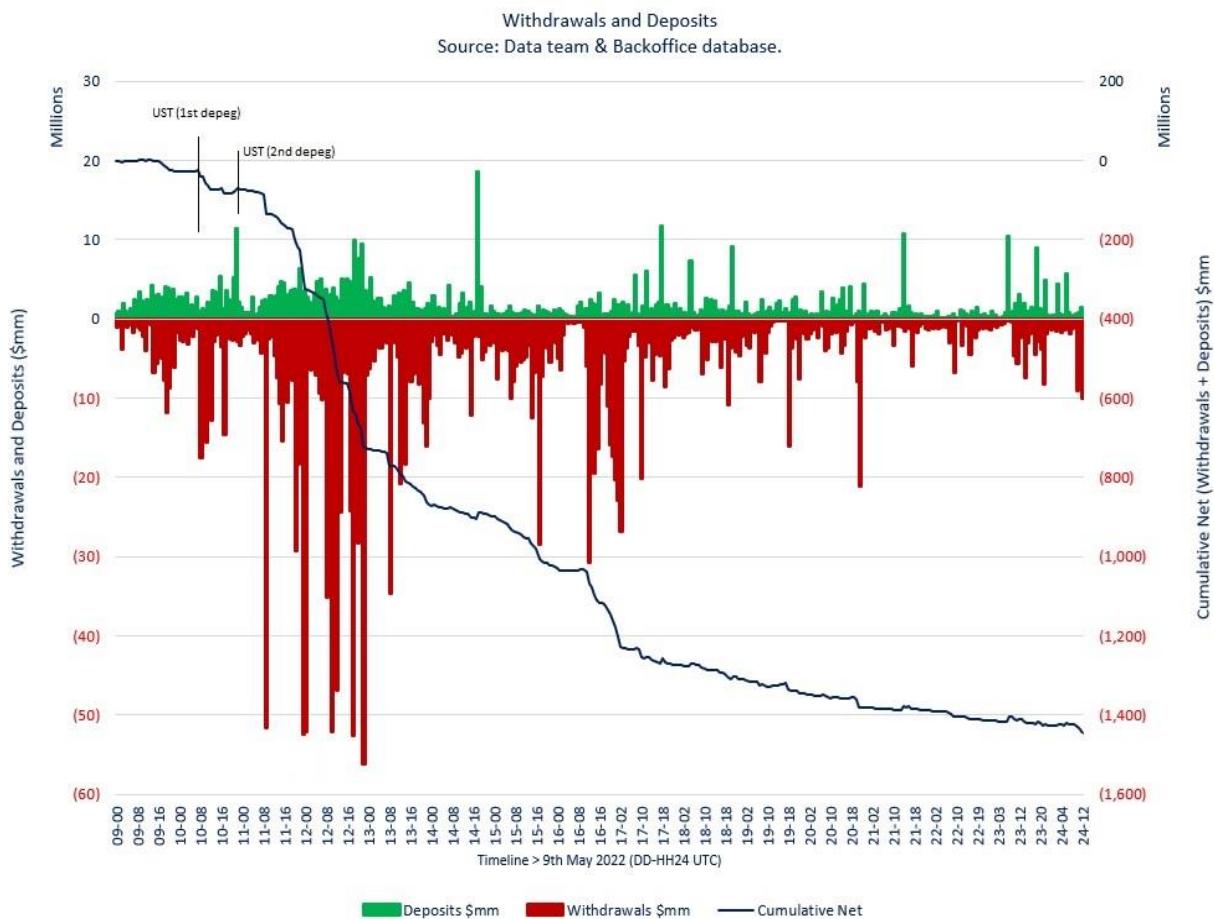
Despite the substantial assets Celsius held, it faced liquidity challenges. In Celsius's May 2022 Board Minutes, it acknowledged that its "capital sits near zero."<sup>266</sup> Moreover, in May 2022, Celsius began experiencing significant customer withdrawals—experiencing a net loss of over \$1.4 billion in assets of its platform between May 9, 2022 and May 24, 2022 alone.<sup>267</sup>

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<sup>265</sup> Celsius, Pending Withdrawal Data – Custody Withhold.xls (November 17, 2022). The Examiner requested, but Celsius has not provided, data reflecting how many Withhold customers sought withdrawals or when the Withhold customers submitted those requests.

<sup>266</sup> Celsius Network: Board Discussion (May 2022), CEL-UCC-00035511.

<sup>267</sup> Celsius, Asset-Liability Committee (ALCO) (May 25, 2022), CEL-UCC-00063742.



By early June 2022, the combination of withdrawal requests and Celsius's deteriorating liquidity pushed Celsius to the financial edge. Between June 10, 2022 and June 12, 2022, Celsius received \$428.3 million in withdrawal requests.<sup>268</sup> By June 12, 2022, Celsius was faced with the reality that it soon would not be able to honor withdrawal requests and/or would take significant losses on the unwinding of deployments to meet withdrawal requests.<sup>269</sup>

Based on these challenges, on June 12, 2022, Celsius announced that “[d]ue to extreme market conditions,” Celsius was “pausing all withdrawals,

<sup>268</sup> Celsius, SOFA3\_2yr compiled excel files (October 27, 2022).

<sup>269</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022).

Swap, and transfers between accounts” (hereinafter “the Pause”).<sup>270</sup> In an internal FAQ approved by Celsius’s legal team after the Pause was announced, Celsius represented that this action was necessary “to stabilize liquidity and operations,” and its “intent [was] to honor, over time, [their] withdrawal obligations.”<sup>271</sup> If asked by a customer whether their funds were safe, Celsius’s legal team instructed its employees to respond, “[y]es, Celsius continues to safeguard customer assets.”<sup>272</sup>

#### **B. Custody And Withhold Assets And Liabilities In The Days Immediately Before And After The Pause**

Between June 2, 2022 (ten days before the Pause) and June 22, 2022 (ten days after the Pause), there were material swings in Celsius’s Custodian Reserve (the net amount between the assets that were considered a part of the Custody program on Celsius’s books and the assets that were actually held in Celsius’s custodial wallets). During this period, Celsius saw a material increase in the amount of assets that were flagged by Celsius as being Withhold assets (but as noted previously, there were no corresponding Withhold wallets).<sup>273</sup>

Schedule 7 provides daily Custody and Withhold account balances on a coin-by-coin basis for a 21-day period consisting of the ten days before and after

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<sup>270</sup> A Memo to the Celsius Community, Medium (June 12, 2022), <https://celsiusnetwork.medium.com/a-memo-to-the-celsius-community-59532a06ecc6> (last visited Nov. 19, 2022).

<sup>271</sup> Celsius Network: Frequently Asked Questions & Approved Responses – Memo, CEL-UCC-00005008.

<sup>272</sup> Celsius Network: Frequently Asked Questions & Approved Responses – Memo, CEL-UCC-00005008.

<sup>273</sup> Examiner Interview of Dean Tappen (Coin Deployment Specialist – Celsius, November 16, 2022); Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

the Pause on June 12, 2022.<sup>274</sup> The Schedule also reflects the number of crypto assets for each coin type held in the Custody wallets as well as the dollar value of those assets.<sup>275</sup> In summary, as of June 2, 2022, Celsius had an approximately \$9.7 million surplus in its Custody wallets compared to the Custody program's liabilities to customers.<sup>276</sup> Celsius maintained a surplus of Custody assets as compared to Custody liabilities through June 9, 2022.<sup>277</sup> On June 10, 2022, one day before the Pause, Celsius's Custody wallets experienced a shortfall, as there were approximately \$196.9 million worth of crypto assets designated for the Custody program but only \$177.2 million worth of crypto assets in its Custody wallets.<sup>278</sup> The Custody wallets' deficit position significantly increased thereafter, with a deficit of at least \$45 million or more through June 28, 2022.<sup>279</sup> Throughout this time, Celsius experienced a substantial shortfall in the Custody wallets.

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<sup>274</sup> Appendix A, Schedule 7.

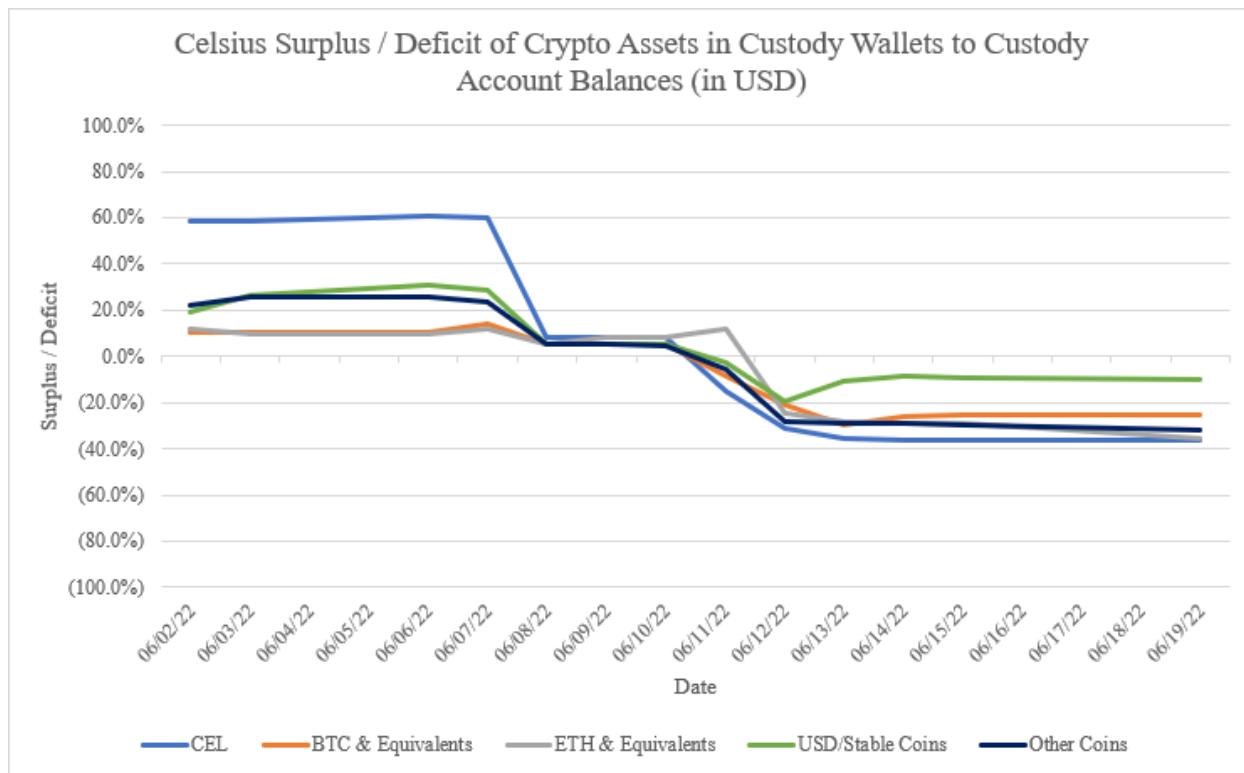
<sup>275</sup> *Id.*

<sup>276</sup> *Id.*

<sup>277</sup> *Id.*

<sup>278</sup> *Id.*

<sup>279</sup> *Id.*



Despite the Pause halting a significant amount of Celsius customer activity (including all customer withdrawal activity), Celsius saw an increase in the account balance for both Custody and Withhold accounts after the Pause. On June 12, 2022, Custody customer account balances were approximately \$203.1 million. By June 15, 2022, the Custody customer account balances had grown to approximately \$213.7 million.<sup>280</sup> On June 12, 2022, Withhold customer account balances were approximately \$14.2 million.<sup>281</sup> By June 15, 2022, the Withhold customer account balances had grown to approximately \$14.8 million.<sup>282</sup>

<sup>280</sup> See Appendix A, Schedule 7.

<sup>281</sup> See Appendix A, Schedule 7.

<sup>282</sup> See Appendix A, Schedule 7.

The increase in Custody and Withhold account balances occurred after the Pause for two primary reasons. First, some customers continued to deposit funds, so certain Custody account balances continued to increase.<sup>283</sup> Second, customer assets were allocated to Custody when they attempted to withdraw their coins from Earn. As noted previously, beginning on April 15, 2022, an Earn customer could not withdraw directly from their Earn account; they first had to transfer the assets to their Custody account and only then withdraw the assets from Celsius.<sup>284</sup> And while Celsius had announced that it was prohibiting all transfers from and within the Celsius platform,<sup>285</sup> at least in some instances, as shown in the chart below, Celsius's systems permitted customers to transfer (on a Celsius internal ledger basis) certain assets from Earn to Custody. Throughout this time, the Custody wallets ran a substantial deficit relative to Celsius's Custody liabilities.

### **C. Post-Pause Funding Of Custody Wallets**

Celsius did not begin to address its substantial shortfalls in the Custody wallets until June 28, 2022, when Celsius added “a certain number of digital assets in Custody wallets to address that mismatch.”<sup>286</sup> The Reconciliation Report ran each day during this time, but Celsius transferred assets from Main

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<sup>283</sup> Celsius, SOFA3\_2yr compiled excel files (October 27, 2022).

<sup>284</sup> Examiner Interview of Juwon Layiwola (Director – Celsius, October 24, 2022). Of course, this “transfer” was Earn to Custody was a ledger transfer only. As explained *supra* all customer withdraws of assets come from Celsius’s “frictional wallets” and not from Celsius custodial wallets.

<sup>285</sup> A Memo to the Celsius Community, Medium (June 12, 2022), <https://celsiusnetwork.medium.com/a-memo-to-the-celsius-community-59532a06ecc6> (last visited Nov. 19, 2022).

<sup>286</sup> Blonstein Decl. at fn.7.

to Custody wallets only three times and in *de minimis* amounts insufficient to meet the existing deficit.<sup>287</sup>

The following summarizes Celsius's June 28, 2022 transfers into the Custody wallets:<sup>288</sup>

Digital Assets Transferred to Custody Wallets on June 28, 2022				
CEL	BTC Equivalents	ETH	USD / Stable Coins	Other Coins
697,108.24	944.70	15,044.24	4,864,823.08	9,880,316.11

The dollar value of the June 28, 2022 transfers to the Custody wallets was approximately \$47.9 million.

Mr. Layiwola and Mr. Ahmed explained that after the Pause, they had “stopped reconciliation and focused on larger business critical needs.”<sup>289</sup> While some acknowledged the “chaos” of the time,<sup>290</sup> Mr. Blonstein “had been operating under the framework that it was a 1-to-1 move to Custody,” and acknowledged that “any time a company says it’s doing something and it’s not, is concerning.”<sup>291</sup>

Celsius continued to make additional smaller transfers to Custody wallets in the following days, such that by the time Celsius filed bankruptcy on July 13, 2022, the deficit in the Custody wallets had largely been erased.<sup>292</sup> Schedule 8 provides a summary of the crypto assets held by Celsius on a coin by coin basis

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<sup>287</sup> See Appendix A, Schedule 1.

<sup>288</sup> Data derived from Celsius, SOFA3\_2yr compiled excel files (October 27, 2022).

<sup>289</sup> Examiner Interview of Adeel Ahmed (Middle Office – Celsius, October 24, 2022); Examiner interview of Juwon Layiwola (Director – Celsius, October 24, 2022).

<sup>290</sup> Examiner Interview (Former Employee – Celsius, November 3, 2022).

<sup>291</sup> Examiner Interview of Oren Blonstein (Chief Compliance Officer – Celsius, November 4, 2022).

<sup>292</sup> See Appendix A, Schedule 4.6.

reflecting coin number and U.S. dollar value as of the Petition Date.<sup>293</sup> Since the Petition Date, the Custodian Reserve deficit returned and as of October 28, 2022, there are approximately 3.2 million fewer coins (or \$16.9 million fewer dollars) in the Custody wallets than assets designated for the Custody program.<sup>294</sup>

### **VIII. Conclusion**

The Examiner's investigation continues and she will file a Final Report covering the remaining topics ordered by the Court at a later date.

Respectfully Submitted,

*/s/ Shoba Pillay*  
Shoba Pillay, Examiner

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<sup>293</sup> See Appendix A, Schedule 8.

<sup>294</sup> See Appendix A, Schedule 4.6.